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G.I. FINANCES: PROTECTING THOSE WHO PROTECT US

HEARING

BEFORE THE

SUBCOMMITTEE ON
CAPITAL MARKETS, INSURANCE AND
GOVERNMENT SPONSORED ENTEREPRISES

OF THE

COMMITTEE ON FINANCIAL SERVICES

U.S. HOUSE OF REPRESENTATIVES

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G.I. FINANCES: PROTECTING THOSE WHO PROTECT US

Thursday, September 9, 2004

U.S. HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON CAPITAL MARKETS, INSURANCE,
AND GOVERNMENT SPONSORED ENTERPRISES,
COMMITTEE ON FINANCIAL SERVICES,
Washington, D.C.

The subcommittee met, pursuant to call, at 10:11 a.m., in Room 2128, Rayburn House Office Building, Hon. Richard H. Baker [chairman of the subcommittee] presiding.

Present: Representatives Baker, Ose, Bachus, Lucas of Oklahoma, Oxley (ex officio), Kelly, Ney, Ryun, Biggert, Kennedy, Brown-Waite, Kanjorski, Inslee, Moore, Hinojosa, Lucas of Kentucky, Israel, Ross, Baca, Matheson, Miller of North Carolina, Emanuel, and Scott.

Also present: Representative Max Burns.

Mr. OXLEY. [Presiding.] The committee will come to order.

Without objection, the gentleman from Georgia, Mr. Burns, may sit with the subcommittee during this hearing and participate in its proceedings. So ordered. The gentleman from Georgia will be recognized for any opening statement or questions only after all those members of the subcommittee have been recognized.

The chair would indicate that Chairman Baker has been delayed. And I would like to begin the proceedings with an opening statement.

I want to thank Chairman Baker for convening this important and timely hearing. I also appreciate the bipartisan interest among the members of this subcommittee in protecting our GIs.

The men and women who protect our freedom by serving in the military are giving our country a precious gift. Through their dedicated service, this nation is successfully fighting terrorism and promoting democracy abroad, keeping America safe and strong into the future.

But as these young men and women risk their lives for our country, we have a responsibility to ensure their financial well-being and protection. New military recruits brought in for basic training are often young and relatively inexperienced on financial matters.

They are trained to obey commands without question and sometimes operate on little sleep. It is unconscionable, if true, that groups of recruits have been marched into compulsory briefings on veterans benefits by salesmen pretending to be financial planners that quick-step them into signing up for what turns out to be long-term life insurance.

It is also unconscionable, if true, that firms are using retired military officers to make on-base sales pitches to groups of young recruits for mutual funds with 50 percent first-year commissions—a product that has virtually disappeared from the civilian market. I have yet to hear any reason at all, let alone a good one, why these products are still being marketed to military personnel.

Perhaps most troubling, these reports are not isolated incidents from boiler-room operations. Some of the biggest names in the mutual fund business are sponsors of these contractual plans sold primarily to military personnel.

Problems with illegal sales practices by life insurance agents on military bases have been reported, studied and debated by the Pentagon going back at least to 1974 and more recently in 1997, 1999, 2000, and 2003. I do not support a complete ban of financial product sales on base, nor do I want to tarnish the good reputation of independent property-casualty agents or those life agents who are not involved in these sales.

But members of Congress can no longer pretend this is about a few bad apples. This is a systemic problem that needs to be fixed.

I understand that NASD has been conducting a thorough investigation of contractual plans for more than a year and will have an announcement in the near future. The NASD is to be commended for its work to protect military investors. I look forward today to a thorough analysis of the problem and potential solutions for Congress to act on this year.

The time of the chair has expired. I will now turn to the ranking member, the gentleman from Pennsylvania, Mr. Kanjorski.

[The prepared statement of Hon. Michael G. Oxley can be found on page 66 in the appendix.]

Mr. KANJORSKI. Thank you, Mr. Chairman.

Thanks for the opportunity to offer my initial thoughts about the marketing of certain securities and life insurance products to military personnel before we hear from our invited witnesses. I want to commend you for swiftly focusing our committee on this important issue.

In recent weeks, several stories in the New York Times have once again raised concerns about allegedly abusive practices in the sale of financial products to the men and women who serve in our armed forces. These accounts have detailed problems with financial literacy, potentially overly trustful troops and business products and practices that have raised the concerns of many.

For example, many financial advisers point out that rather than committing to long-term contractual plans with large front-load fees, most investors would be better off setting up automatic savings programs with smaller fees and initial sales loads. Additionally, while many in the military may have greater life insurance needs than average Americans, we need to ensure that the products they purchase meet their needs and best serve their long-term purposes.

Without question, we need to work in Washington to protect those who protect us. As a result of today's proceedings, I hope that we will gain a better understanding of the military financial services marketplace.

We already know that our soldiers are more mobile than average Americans. The recent news reports have also highlighted potential limitations faced by financial regulators on military bases, particularly on those installations located abroad. Both of these issues deserve better exploration today.

In recent days, we have also begun consideration of legislation that would ban the sale of mutual fund contractual plans. This bill also seeks to improve the regulation of life insurance and other financial products sold on military bases. In order to prevent unintended consequences, I must urge my colleagues to move deliberately and diligently in these matters.

As at least one witness points out in his prepared testimony, efforts to eliminate contractual agreements might have an effect on variable annuity market. It could also result in problems for those who have already purchased these plans.

Before we move ahead in these matters, I would therefore urge you, Mr. Chairman, to consult with the Securities and Exchange Commission, the National Association of Securities Dealers, the National Association of Insurance Commissioners, the Department of Defense and other interested regulatory entities to ensure that any bill we craft appropriately fixes these problems before we adopt them into law.

In closing, Mr. Chairman, we need to improve financial education for military personnel. We need to improve the enforcement of consumer protections for not only the men and women in our Armed Forces, but also for all Americans. We additionally need to have better supervision in the sales of financial products on military bases.

I want you to know that I am committed to addressing these matters. These are important discussions for us to have and important matters for us to resolve.

Thank you, Mr. Chairman.

[The prepared statement of Hon. Paul E. Kanjorski can be found on page 73 in the appendix.]

Chairman BAKER. [Presiding.] Thank the gentleman.

Let me express my apology to members and our witnesses for my late arrival. I am usually very prompt about starting our committee hearings. And matters beyond my control kept me from being here at my usual hour.

Our hearing today is one that is unusual from several perspectives. We are here to review the effectiveness and desirability of not only an insurance product, but a securities product as well. Both matters are clearly within the jurisdiction of this subcommittee.

The products are unique. They were intentionally designed to serve the needs of military personnel.

Some of the products have been designed for civilian utilization in years past. And as long ago as 1966, the SEC suggested really rather radical reform of the manner in which these products were marketed; for example, in one such regulatory recommendation, that the first year load drop from 50 percent to 5 percent. I would consider that radical.

However, for whatever reasons, actions have not been taken with regard to those pending recommendations since initially forwarded.

I think one of the reasons that we have seen these products, in all practical purposes, eliminated from the civilian marketplace is from competitive forces.

Why is that so? Basically, when you have a product which is priced at a very high end of the market, which provides at the same time benefits on the very low end of the market, anyone who has a choice simply will make another choice.

That being the case, the product has disappeared from the civilian marketplace. I have observed that when you have a choice between a no-load, a low-load or a what-a-load, you are probably not going to go for option 3.

Military personnel headed to a theater of war, however, do not find themselves focused necessarily first on matters of finance. They do, however, have concerns about the wife, the spouse, the kids, not sure of what the fortunes of war may bring.

In these desperate hours before being assigned, who is there to help them make that decision? Regrettably, it is the marketing of the product in this case which also causes me some significant concern.

This is not a product marketed via the television, by mail or by someone knocking on the door in a three-piece suit. When you look across the table as an anxious young military person, you are met by a retired military officer, who assures you that this is the right decision for you personally, for your family and for your future. All that is required is for you to sign here, son.

That is probably more problematic than anything else about this circumstance. The product worth in relation to similar products in the civilian market is highly dubious. But the fact that these individuals are emotionally not centered on matters of finance, fully focused on military service and being told by senior retired military officials that this is the right thing to do is very troublesome.

I have spent a lot of time, as well as every member on this committee, in matters of Enron, WorldCom, dot-coms and everything else. At least in those instances where investors put money into what most members of this committee consider to be outrageous investments, those investors at least had a chance not to be swept up by the hype. In this case, I do not believe the victims had a choice.

The first legislative response posed to the identified concerns is that by Congressman Max Burns with House bill 5011, which I am advised by Chairman Oxley that the subcommittee and full committee will review and take action in due course, as is warranted.

And certainly, I join with my colleague, Mr. Kanjorski in welcoming the comments of all of those who have regulatory perspectives on the appropriateness of this product, the congressional response appropriate and ensuring that we take action that is in the best interest of all.

It is troubling that those who have already invested, whether in active duty service or now retired, it may be the only remedy for them to date is to ensure the product remains a viable contract for its maturity in the hope of regaining some financial remuneration at the end of the contract. However, going forward, it is pretty clear, at least at this juncture, that these products do not offer what they hold out to the marketplace in the military.

And we have a direct responsibility, in light of all the other hardships our military personnel face. How can we stand by and not take corrective action in this clearly identified, what I consider to be abusive, practice?

Mr. Hinojosa? Mr. Hinojosa.

Mr. HINOJOSA. Mr. Chairman, I wish to yield at this time. I do not have a prepared statement.

Chairman BAKER. Mr. Israel?

Mr. ISRAEL. Thank you, Mr. Chairman. I appreciate your convening this hearing. And I also want to thank my ranking member, Mr. Kanjorski, for his participation in this.

Mr. Chairman, the process by which we insure our troops is simply dysfunctional. It is doing more harm than good in too many cases. And I want to share, in the time that I have allocated to me, just two cases in particular.

One is the case of Raheen Tyson Heighter, who lived in my district; 19 years old; enlists in the Army and wants to go to Iraq and fight for his country. He is told he needs life insurance.

He says, "I am 19 years old. I really do not need life insurance." He is told, "Well, you have to have it." And he says, "What is the cheapest policy that I can buy?" And they tell him a $10,000 policy.

He goes to Iraq. He is the first Long Islander killed in action in Iraq. And his mother gets a call from the Army saying, "All your son bought was a $10,000 policy. We are sorry."

That is dysfunctional. That is doing more harm than good.

The second case is a member of my own staff here in Washington who graduated West Point, also served in Iraq. He sat through a sales pitch in the officer's club at an Army base where he was clearly exposed to explicit deceptive coercive marketing practices.

Now we owe Raheen Tyson Heighter and my staff and all the members of our armed forces much better than that. We owe them the best and not the shoddiest of protections.

And I wish that Congress would pass the bipartisan legislation that I have introduced as a member of the Armed Services Committee. I serve on the Armed Services Committee and the Financial Services Committee.

And we have bipartisan legislation called the Raheen Tyson Heighter Life Insurance for America's Troops Act that would simply say this: that if we are going as a country to send young men and women into battle, we will take care of their life insurance for them.

We will not make them dig into their pockets in order to pay their premiums. We will take care of them. We ought to pass that bipartisan bill, sooner rather than later.

Those who are taking care of our national security should not have to worry about their financial security at home. And when it comes to insurance sales, we should not have to protect the protectors against coercive and deceptive marketing practices.

I appreciate the fact that we are having this hearing. And I intend to ask some questions when it is appropriate.

Thank you, Mr. Chairman. I yield back the balance of my time.

Chairman BAKER. I thank the gentleman.

Mr. Lucas?

Mr. Ney?

Mr. NEY. I will be very brief, Mr. Chairman, because I know we have witnesses and we want to get to the subject. I have a statement for the record I would like to submit.

[The prepared statement of Hon. Robert W. Ney can be found on page 77 in the appendix.]

But I just wanted to say thank you to the chairman for having the hearing. We have issues in predatory lending and then also issues obviously of predatory practices that we have to look at.

I did want to point out that there is a young gentleman whose mother is in Athens, Ohio. And it is a very compelling argument as to why this should be looked at today.

Bottom line, he thought he was having $100 deducted out of his pay, which was going to be in some type of fund. The worst part is not only did he get back and find that that was not in some type of fund, but that he had paid $100 a month, according to this article, for less than $44,000 of insurance. About a $250,000 policy, young person's age, male or female, would be about $17, I think, or maybe $20 or so a month. So these are not good practices.

Also, I wanted to point out too—and this might have been said before; I apologize if it has been—but you know, these are young men and women that are being trained. And they are trained to observe the military order. And all of a sudden, they are in a military setting. And I think that could also influence them just to do this.

So thank you, Mr. Chairman, for the hearing.

Chairman BAKER. I thank the gentleman for his statement.

Mr. Emanuel?

Mr. EMANUEL. Thank you, Mr. Chairman, for holding the hearing and for following the request I asked for this hearing.

I think the question we need to ask ourselves is, at least about the contractual mutual fund instrument, is: if it is such a great product, why is it not marketed to the general public? And if it is not good enough for the general public, why are we allowing it to be sold to men and women in uniform and on our bases?

The mutual fund industry is about $7 trillion; about $15 billion worth of contractual mutual funds, one-eighth of 1 percent. And it is almost all of that is held by people in uniform.

It is not sold to the general public because of what the SEC had recommended in the 1960s and 1980s. And it basically fell out of favor in the market. And we should not encourage this—if not outright ban it—on our bases and to our men and women in uniform.

Many of our troops are of modest financial means and do not need to be spending those types of resources in this type of account. And I do not think those in the industry should view the men and women in uniform as a fee machine, where they literally turn them on as an ATM machine to generate fees for themselves, especially given the—I think—high, high, high, high costs of 50 percent upfront in the first year in the sense of the fee that the agents receive.

I also think it is important, as we deal with the life insurance issue, that we have adequate disclosure, so it is crystal clear to our servicemen and women what they are buying and what they have available to them. It is important that the companies give recruits plain English documents, telling them the U.S. government does

not endorse, recommend or encourage them to buy this type of life insurance.

As I think everybody in the industry agrees, informed investors or informed consumers is a good thing. So let's inform them and give them all the information.

The clear disclosure and informed consent are the keys here to success. That is why I am going to introduce legislation with the Virginia senator from New York.

It would ban contractual mutual funds. And if we could not succeed in doing that, as has been tried in the past and recommended by the SEC, we give what is the equivalent of a surgeon general's warning, an SEC warning, warning that: they are harmful to your financial health; there are 50 percent commissions; they are not sold to the civilian or general public anymore; and that the SEC recommended that Congress, back in the 1960s or earlier, ban them.

For troops whose families feel that they need to purchase more than $250,000 in life insurance, my bill would allow them to buy up to $500,000 in insurance from the government at the same low cost that the government already provides at the $250,000 level.

It also requires new disclosures, tightens the guidelines for base access and clarifies the role of state insurance regulators. So that would be the legislation I will be introducing.

I look forward to today's panel and appreciate the fact that the subcommittee and the full committee will look at legislation and are holding this hearing today.

Thank you, Mr. Chairman.

[The prepared statement of Hon. Rahm Emanuel can be found on page 69 in the appendix.]

Chairman BAKER. Thank the gentleman.

Mr. Ryun?

Mr. RYUN. Mr. Chairman, I want to thank you and the subcommittee for scheduling this hearing. The issue of protecting the men and women of our military from abusive sales practices is one that should receive our careful attention, as it is today.

As we consider how to best govern the sales of financial service products to our military installations, let me be very clear about one thing: the first priority of this committee should be protecting our servicemembers from those who would prey on them for financial gain. Standing by while our servicemembers are taken advantage of is not an option.

This goal must also be shared by those in the business of providing financial services to our men and women in uniform.

The abuses that have been recently publicized are extremely disturbing. This committee must determine what actions are necessary to put an end to these abusive practices.

These actions must not be a mere gesture, but must provide sound protection for our soldiers. It is important that the bad actors be rooted out, not only to eliminate predatory practices, but also to allow those doing business with integrity to better service our servicemembers.

Among the practices that we must take a look are the sales of investment plans with large front-end fees. These plans are almost

nonexistent in the civilian market, as we have already talked about, yet remain prevalent on the military bases.

It is important to ask why a product that is not available to the general public is sold to our servicemembers. While I generally oppose federal intervention on this sort of transaction, there is enough concern with the structure of these plans to warrant our consideration.

One word of caution though: it is important that we address the problematic plans without unintentionally affecting other non-offending financial products.

We must also do what we can to preserve the authority of our base commanders. These commanders already have the authority to prohibit access to their base. And we must be cautious that our efforts do not compromise their authority.

One of our base commanders' most fundamental responsibility is protecting those residing on the base. If a commander deems an agent or a company unfit to do business on the base, their decision must stand. We must also help the base commanders obtain the knowledge necessary to go ahead and make their decisions.

Next, it is necessary to improve interaction between state regulators and military bases. It is a significant problem when financial sales on military bases are not accountable to the same standards that govern similar sales made off the base.

We must also protect the right of our soldiers to have access to a competitive financial service marketplace. Some have proposed prohibiting outside providers from selling financial services products on our military bases.

I oppose this proposal. It would essentially remove all competition, leaving our soldier with only on-base institutions for financial services. Surely, protecting our servicemembers must involve giving them the choice of where to conduct their financial affairs.

I do not have all the solutions to this problem that exists. However, I am pleased that this committee has recognized that there is a problem. And I hope that some real protection for our soldiers will result from our efforts here.

I am committed to working for changes that provide critical protection and that promote the most choices for our men and women in uniform. We are here today to find solutions for our soldiers. I look forward to the panel of witnesses. And I thank you, Mr. Chairman.

Chairman BAKER. Thank the gentleman for his statement.

Mr. Hinojosa, did you wish to make your statement now, sir?

Mr. HINOJOSA. Yes, thank you.

Chairman Oxley and Ranking Member Frank, thank you for holding this very important and timely hearing today. As we all learned this week, 1,000 U.S. men and women have lost their lives during Operation Iraqi Freedom. And each, including several from the Rio Grande Valley, which I represent, should be remembered for their courage and valor in defending our nation and the principles for which it stands.

Based on the information I have received in my office, it seems to me that more than 70 percent of the dead are soldiers in the Army. And more than 20 percent are marines.

More than half were in the lowest-paid enlisted ranks. On average, the servicemembers who died were about age 26. The youngest was 18; the oldest, 59.

About half were married, according to the death roll, which does not include a handful yet to be identified by the Defense Department and three civilians who worked for the military. Part-time soldiers, the guardsmen and reservists who once expected to tend to floods and hurricanes, were called to Iraq on a scale not seen through five decades of war.

Increasingly, Iraq is becoming the conflict of the National Guard. And in growing numbers this spring and early summer, these part-time soldiers died there.

Ten times as many of them died from April to July of this year as had in the war's first 2 months. This past weekend, the Rio Grande Valley lost another of its soldiers while bravely serving our country during Operation Iraqi Freedom.

On September 6, United States Army National Guardsman Tomas Garces died in Iraq. Garces died when his convoy was attacked by enemy forces using an improvised explosive device.

Garces was assigned to the National Guard's 1836th Transportation Company from Fort Bliss, Texas. And his family resides in Weslaco, Texas, which is in my congressional district.

At just 19 years of age, Tomas' loyalty to the cause of freedom was steadfast and clear. A 2003 graduate of Weslaco High School, Tomas was a champion wrestler and took his lessons from the mat with him to the Guard. In July, he had been recommended for a Bronze Star for his actions during an ambush.

These brave troops in our nation's military are working every day to guarantee the safety, security and freedom for Americans and Iraqis. And Tomas was no exception.

My thoughts and prayers are with his parents, Rafael and Sonia, his brothers and sister and his entire family at this difficult time. Garces is the tenth soldier from the Rio Grande Valley to die in the line of duty in Iraq since the conflict began.

These individuals tend not to be well-versed in financial services issues. Some of them do not even have bank accounts. Unfortunately, this is not very uncommon in the United States in general, as financial literacy in this country is abysmal.

While I must condemn any company or industry that preys upon these brave individuals who risk their lives for our country and our democracy, I realize that sometimes the negative actions and sales are done by a few bad apples and do not represent the industry as a whole. Life insurance and mutual funds, when appropriately crafted and appropriately marketed to our military, are just that—very appropriate.

In closing, I want to say that when someone goes after a financially unsophisticated, courageous youth headed into battle with a product that will not benefit his family if he does not return from his tour of duty alive, I have to draw the line.

Mr. Chairman, I hope today's hearing will shed light on the inappropriate sales of contractual mutual funds to our military personnel. And I would hope that all of you would pray for the families of our lost soldiers.

I yield back the balance of my time.

[The prepared statement of Hon. Rubén Hinojosa can be found on page 71 in the appendix.]

Chairman BAKER. I thank the gentleman.

Chairman Bachus?

Mr. BACHUS. Thank you, Chairman Baker. And I want to commend you for holding this important hearing. And I want to commend another member, Representative Max Burns.

Congressman Burns has taken the lead in this Congress on protecting the men and women in uniform from this practice. He was the first member I know of in Congress that spoke out about this matter. And he did so before publicity on this matter reached the press.

And I am joining him as a cosponsor on legislation that he is introducing this morning. And I would ask each member of this committee to take a look at that legislation.

It takes a reasoned approach. I am happy to say that independent property and casualty agents did not participate in this. And it was only a small minority of mutual funds and life agents.

And I think Congressman Ryun mentioned that these practices basically disappeared from the private market some 20, 25 years ago because they offered very little value. And what we are talking about here is in the first year of premiums, which is $1,200, $600 of that goes to commission.

But probably the thing that shocks me the most is the Department of Defense, back in 1986, issued a directive that ought to prohibit this type of thing. This was done in direct violation of Defense Department regulations.

And I will close simply by quoting that. The directive "prohibits solicitation of recruits, trainees and transient personnel in a mass or captive audience, using misleading advertising or sales literature or giving the appearance that the DOD endorses any particular company."

Now despite that, there is at least reports in the media that these recruits were brought in and that insurance agents posing as counselors on veterans' benefits and independent financial advisers then advised them to purchase this product. They did it while they were on duty. They did it in their barracks, violating two more Defense Department regulations.

And apparently—and this disappoints me—their commanding officers arranged all this, which I think, as a former enlisted man, sounds to me like an abuse of the chain of command and an abuse of the enlisted men.

But I do think this: I am surprised that the state regulators and those who regulate our regulators have not stepped in and done something about this. It should not have gone on this long.

I commend Congressman Burns. And I think his bill takes a reasoned approach.

It does not blast everybody. It allows your state insurance and your security regulators to do their job.

And I think the Pentagon also needs to get back involved and engaged on this issue. But I want to thank you, Congressman Burns.

Chairman BAKER. I thank the gentleman for his statement.

Mr. Scott?

Mr. SCOTT. Thank you very much, Mr. Chairman. I too want to thank the committee for this very, very important hearing.

What we have before us today is scandalous. It is shameful and, especially at a time of war, taking advantage of young, impressionable soldiers.

What bothers me more than anything else about this is that there is apparent collusion going on within the military itself. It is shameful that these unscrupulous, shall we say, "insurance agents" are allowed to even go into barracks and to confront soldiers who are under pressure, the pressure of their lives being flashed before them, as they are being trained and prepared to go overseas to risk their lives.

Eighteen-, 19-, 20-year-old kids are being swamped with very complex financial details of life insurance and contractual plans whose practices have been outlawed in the public sector many, many years. And yet this activity has been going on for over 30 years.

And to have military personnel, high-ranking generals serving on the boards of directors of these companies. And what is so disturbing is that these are veterans who are taking advantage of these young enlisted men.

There is no more important assignment than we can be faced with today, ladies and gentlemen, than correcting this mess. Harry Truman said it right, "The buck stops here."

The military has got some tall walking to do today because I think that there are some dirty hands here. The insurance industry has some tall walking to do today.

And I am looking forward to this Congress doing its rightful duty of oversight. There is indeed enough blame to go around to all of us.

Let us make our resolve this morning in this committee to right this tragic wrong and to give our young men and women in uniform the dignity and respect that they need. Maybe it is regulation; maybe it is outright banning of some of these products.

I think there should be free exercise of enterprise, to have competitive products being on military bases. I do not think banning insurance companies from going on is the right thing.

But we can do a better job. And we have to do a better job.

And one thing we have to do, more than anything else: we have to understand the importance of financial literacy. Nowhere is there a greater example of the need for it than in preparing and equipping our men and women in uniform with the information that they can arm themselves with.

Chairman BAKER. The gentleman's time has expired.

Mr. SCOTT. I look forward to the rest of the hearing. Thank you, Mr. Chairman.

Chairman BAKER. I thank the gentleman.

Ms. Brown-Waite?

Ms. BROWN-WAITE. Thank you very much, Mr. Chairman.

You know, I think the title of this hearing is very appropriate, "Protecting Those Who Protect Us." And when you read through the material and you read the newspaper articles—and believe me, I am not somebody who believes everything I read in the newspaper—but when you read through both the staff research and the

newspaper articles, I am ashamed that we had to hold this hearing today.

You know, insurance companies should not have taken advantage of young men and women who are really fiscal neophytes. Most of them have never had a checking account.

So many of them join the military right out of high school, right out of college, where they really have no experience. They have no idea of what a mutual fund really is.

And equally important, I think that the Department of Defense needs to be called on the carpet as to why they have not abided by their own Rule 1344.7. I think the military was doing a "wink and nod" approach to this. And that is just wrong.

Every one of us in Congress has lost young men and women in the war in Iraq and Afghanistan. And to think that these young men and women who do not understand had the Department of Defense let them down by having them be captive audiences, which is a direct violation of the Department of Defense's own rules.

I think, on behalf of the young men and women, on behalf of their families, who are making such sacrifices, that the Department of Defense has a lot of answering to do. It is absolutely shameful.

And I commend Mr. Burns and have agreed to go on his legislation. It is a measured approach and one that I am ashamed to say that we have to be here to even consider. Because if the Department of Defense had done its job and if some of the insurance companies had not been so damn greedy, we would not even be here today.

Mr. Chairman, I yield back the balance of my time.

Chairman BAKER. I thank the gentlelady.

Mr. Moore?

Mr. MOORE. Thank you, Chairman Baker. And I want to thank you and Ranking Member Kanjorski for convening this hearing. I think this is very, very important.

And I have learned a great deal already, just in hearing opening statements by some of my colleagues. I was not aware of Mr. Israel's bill, which has been pending for some time—I guess about a year now—and looks to be very good.

I also have seen Mr. Emanuel's bill. And that looks good. And I have heard about Mr. Burns' bill this morning. So I want to take a look at all those.

I want to take just a slight twist on this. And it gets just a little—it is collateral to this, but I think it is very important as well.

I was stunned when I learned that our troops, young men and women who might be killed in Afghanistan and Iraq, had a death gratuity benefit from our country of $12,000. I say "stunned" because to me that is almost like a slap in the face.

We talk about how much we value our troops and the good job they do for us. And I think virtually everybody in Congress believes that.

But to pay $12,000 to the family of a young person who has been killed in Iraq or Afghanistan to me was just not showing value and appreciation for our troops.

I have a bill today and just started talking to my colleagues yesterday and have four Republicans and four Democrats on it right

now. And it should not be partisan at all. It would provide a $50,000 death gratuity benefit to young people who are killed in Iraq or Afghanistan.

And whether it is a financial services product, such as life insurance, that we help them out with, or whether we provide a death gratuity is not as important to me as the fact that we somehow show a greater understanding and appreciation for the situation our young men and women face when they are in the military forces and that we provide some benefit to them—again, through life insurance payments, maybe or a death gratuity benefit. But I think we need to do a better job than what we have done in the past.

And again, Mr. Chairman, thank you for convening this hearing.

Chairman BAKER. I thank the gentleman for his statement.

Ms. Kelly?

Mrs. KELLY. Thank you, Chairman Baker, for holding this hearing to ensure that we are protecting the individuals who have made sacrifices for our nation. Since we do not teach financial literacy in our schools, we have to help our military personnel receive the financial shelter and guidance that they deserve and that the public needs to demand.

And this includes ensuring that the servicemen and women have access to clear and accurate financial information and advice that meets both their short-term and their long-term needs. I represent three military installations: Camp Smith in Cortlandt Manor, the United States Military Academy at West Point and Stewart International Airport at Newburgh, which is a large reserve air base.

I have been deeply troubled by the recent allegations of the abusive practices in the sale of financial products to the military personnel. In spite of a directive from the Department of Defense restricting commercial solicitations, there have been reports of agents selling insurance and investment products that may not be in the best interests of the people in uniform.

This committee needs to learn more about the contractual plans, those that enable an investor to make gradual contributions to a mutual fund that may have steep front-end sales loads. It is my understanding that the contractual plans have more or less disappeared in the civilian market several decades ago because they are not widely marketed because of the pricey sales charges. And there is very little flexibility built into them.

We need to hear about some of the other insurance products that are marketed to military personnel. It is my understanding some of these products are not well structured for the unique needs of our servicepeople and that some of the policies offer very little more than high premiums and very low benefits.

More troubling than some of the misguided and inappropriate products being marketed toward our military personnel are some of the questionable and misleading tactics that have been reportedly used to sell these products to our military. There are reports of individuals posing as counselors on veterans' benefits and independent financial advisers, sometimes when the soldiers are in their barracks or even on duty.

And there are other accounts of individuals pressuring military personnel with the deceitful implication that their supervisors or

government support products and services they are selling. While there are a lot of honest and helpful life agents and brokers with good intentions out there, our military personnel deserve better service.

And I believe that the agents and brokers not only have a fiduciary responsibility to their clients, but they have a personal responsibility to our service personnel.

I look forward to hearing from our witnesses about the financial products marketed to military personnel and the sales practices that they employ, as well as the potential solutions to try to improve protections for military personnel. The men and women of our armed forces make sacrifices every single day. And they exemplify the best of American spirit.

They take care of us. We need to take care of them. We have to get them all the support, compensation, benefits and protections that they deserve.

This hearing is important. And I am happy that you have held it.

I also, Mr. Chairman, would like to insert in the record at this time a statement from the Insurance Marketplace Standards Association.

Chairman BAKER. Without objection.

Mrs. KELLY. Thank you very much.

[The following information can be found on page 164 in the appendix.]

[The prepared statement of Hon. Sue W. Kelly can be found on page 75 in the appendix.]

Chairman BAKER. I thank the gentlelady.

Mr. Ross?

Mr. ROSS. Thank you, Mr. Chairman.

It is a little loud this morning.

Thank you, Mr. Chairman and Ranking Member Kanjorski, for holding this hearing on our soldiers and finances and protecting those who protect us.

There has been a lot said. And I will be brief so we can hear from our panel of witnesses this morning.

I think we all know that one of the reasons we are here is these abusive practices in the sale of financial products to military personnel, which have been uncovered. I would particularly like to thank the 6-month examination that was done by the New York Times that found that several financial service companies or their agents are using questionable tactics on military bases to sell insurance and investments that may not fit the needs of people in uniform.

I have a brother-in-law in the United States Air Force. I have a first cousin in the United States Army whose wife gave birth to their first child while he was serving our country in Iraq.

Today, we have some 3,000 Arkansas National Guard soldiers in Iraq. Last month, I was in Baghdad to visit with them.

These are people that I once taught Sunday school to, people I duck hunt with, people whose wives back home teach my children. It really puts a face on it.

And I believe their service and the service of all men and women in uniform is much greater than mine or any member of Congress

or any president or vice president's could ever be. And I believe if they are going to go across the globe and protect America and our interests, the least we can do is protect them and their finances at home.

And that is why I want to thank the chairman and the ranking member for holding this important hearing today. I want to thank my colleague from Long Island, Mr. Israel, and Mr. Emanuel for their leadership on this issue. And hopefully, we can work together in a bipartisan manner to try and ensure that these practices stop and that our men and women in uniform and their families back home are protected from such fraudulent and deceptive sales pitches.

Thank you, Mr. Chairman.

Chairman BAKER. I thank the gentleman.

Ms. Biggert?

Mrs. BIGGERT. Thank you, Mr. Chairman. And thank you for holding this very important hearing today, for I believe it will send a clear message to our military personnel that we do care about their financial welfare. These men and women serve and sacrifice for America, and for the world, to ensure that all people dwell in freedom, liberty and justice.

As you may know, financial literacy is one of my top priorities. And it has been brought to my attention that financial organizations have voluntarily met with servicemen and women to educate them about financial services.

While I encourage bona fide financial education programs that are conducted in a legal and ethical fashion, I am not an advocate for programs that violate Defense Department regulations or that are a sales pitch fronting as a financial education program. I am disturbed to read that young and impressionable members of our armed forces may be fooled into believing that they are being educated about finance, but are in fact being influenced by salesmen who pose as instructors.

I would encourage our witnesses today to fully disclose the accuracy of the report that "several financial services companies or their agents are using questionable tactics on military bases to sell insurance and investments that may not fit the needs of people in uniform."

Our military should know that we in Congress will not deny them access to the financial benefits of a free-market society, but we will take action, if necessary, to protect them from financial scam artists.

I look forward to hearing from the witnesses. Thank you and I yield back.

[The prepared statement of Hon. Judy Biggert can be found on page 68 in the appendix.]

Chairman BAKER. I thank the gentlelady.

Mr. Inslee?

Mr. Matheson?

Mr. Miller?

If there are no further members having opening statements, I would like at this time to ask unanimous consent——

Mr. OXLEY. Already granted.

Chairman BAKER. Oh, then by prior agreement, at this time, I recognize Mr. Burns.

Mr. BURNS. I thank the chairman and the ranking member. I appreciate the opportunity to join the committee this morning for this certainly important hearing.

This past Tuesday, I was joined by colleagues—Mike Simpson, Charlie Norwood, Chet Edwards and Joe Wilson—in introducing H.R. 5011, which is the Military Personnel Financial Services Protection Act. The purpose of this act is quite simple: it would ban the sale of questionable financial products and insurance policies on military bases, both at home and abroad.

The bill would also provide a layer of oversight on unscrupulous insurance companies and their employees that have been using federal military property to evade the jurisdiction of state insurance commissioners and other state regulatory bodies. Those who sell products to our citizens, especially to our troops who sacrifice so much for the freedoms that we all enjoy, have a responsibility and a duty to be honest and clearly inform their potential customers.

Clearly, there have been transgressions in these areas that must be addressed. In the past weeks, I have become aware of numerous servicemembers, including those residing in Georgia's 12th congressional district—Fort Gordon, Georgia; Fort Stewart and Hunter Army Airfield, Georgia; the Navy Supply Corps School in Athens, Georgia, all of which are in the 12th—have suffered financially as a result of dubious financial products and questionable insurance policies.

I and my colleagues will not sit by and watch innocent members suffer from unscrupulous sales practices in our military installations. I look forward to the testimony of the witnesses. I look forward to working with the Financial Services Committee and congressional leadership in crafting an effective bill to deal with this challenging problem.

I again thank the chairman and the ranking member for the opportunity to join you today. I yield back.

Chairman BAKER. I thank the gentleman for his good work and his participation here today. We now turn to our patient witnesses for their remarks this morning. And it is indeed an honor for me to introduce to the committee today Specialist Brandon Conger, United States Army, who has just returned from a tour of duty in Iraq.

Sir, I wish to extend to you my deep appreciation for your service. And we are honored to have you here with us to give us your concerns.

Please proceed as you would like. Normal practice requested by the committee is that all witnesses try to make their presentations within 5 minutes. Your full and complete statement will be made part of the official committee record.

Welcome.

STATEMENT OF SPECIALIST BRANDON CONGER, UNITED STATES ARMY

Mr. CONGER. Thank you.

Mr. Chairman, distinguished members of the committee, good morning. My name is Specialist Brandon Conger from Butler, Mis-

souri. I am infantryman with headquarters in Headquarters Company, 2nd Battalion, 325th Airborne Infantry Regiment, 82nd Airborne Division.

Thank you for this opportunity to testify in front of the committee. I would like to give you a brief synopsis of my involvement with American Amicable Life Insurance.

In August 2002, during my third week of basic training in Fort Benning, Georgia, my drill sergeants held a briefing for my platoon concerning a group of financial advisers. The drill sergeants explained to us that a group of financial advisers were coming to speak with us about mutual funds.

The drill sergeants said that they were a good investment. And if we started now and stuck with them, that we would make lots of money.

The next day, the financial advisers held a classroom briefing and specifically told us that by investing money in these mutual funds, it would only help us make money. They showed us charts on their laptops, showing each of us individually how much money we would make long term, depending on how much money we put in on a monthly basis.

They then passed out paperwork to sign an order for the money to begin coming out of our bank accounts. Neither the financial advisers nor our drill sergeants or the paperwork said anything about life insurance.

I had ACLI. I was putting in $20 a month for the insurance in the Army. I did not need life insurance.

After graduating basic training airborne school, I was assigned to the 82nd Airborne Division in January 2003. By then, I still had not received a statement of any kind from American Amicable.

In March 2003, my unit deployed to Iraq in support of Operation Iraqi Freedom. Late January of 2004, I redeployed back home to Fort Bragg, North Carolina.

In February of 2004, after still receiving nothing from the company, I decided to call them. Most of my calls were never answered. And those that were ended up with me being put on hold until I hung up the phone.

Finally, in April, a fellow paratrooper who had signed up with the same financial company told me that this group of financial advisers was a fraud. I then cancelled my allotment.

In May, a reporter from the New York Times who wanted to hear my story, contacted me. That same month, I informed my company commander and we called American Amicable and requested a copy of my insurance policy be mailed to the unit.

A couple of weeks later, after I still had not received the policy, my commander and I called and e-mailed American Amicable, requesting a policy again. Finally, on the 23rd of July, I received my insurance policy.

This has been an extremely disappointing ordeal for me and for some of my fellow soldiers, not because I lost money, but because I was misrepresented by a former soldier working for American Amicable Life Insurance, who used his contacts to gain the trust and confidence of young soldiers.

Again, Mr. Chairman, I want to thank you and the committee for allowing me the opportunity to testify today. Thank you.

Chairman BAKER. Thank you, sir. And I assure you, we will take your testimony and review it very carefully and we will act accordingly. We appreciate your willingness to participate.

Our next witness is Ms. Elizabeth W. Jetton, president, the Financial Planning Association. Welcome, Ms. Jetton.

STATEMENT OF ELIZABETH W. JETTON, PRINCIPAL, THE FINANCIAL PLANNING ASSOCIATION

Ms. JETTON. Thank you.

Thank you, Chairman Baker and Ranking Member Kanjorski and members of the subcommittee for this opportunity to testify today on the marketing of certain insurance and investment products to our enlisted men and women on military bases.

My name is Elizabeth Jetton. I am a partner in an independent financial planning firm in Atlanta and hold the "Certified Financial Planner" designation. I appear before you today as the president of the Financial Planning Association.

FPA represents more than 28,500 members who provide professional advice to individuals and their families or to those who support the financial planning process. Recently, FPA began a national community services program to provide pro bono financial planning and education, delivered by certified financial planner practitioners to those in need and unable to pay for professional advice.

As part of this program, we are currently in discussions with the Pentagon representatives to see how we can provide pro bono advice to reservists and National Guard personnel called to active duty in Iraq.

I have personally been in the financial services industry since 1980 and have previously held an insurance producers' license. For the past 14 years, I have been in the practice of comprehensive financial planning, registered with the State of Georgia Division of Securities as an investment adviser. I am also affiliated with a broker-dealer and am licensed to sell securities.

I was personally disturbed to read about the allegations of abusive sales practices to our men and women in uniform. And I am particularly concerned about those who are young and starting out in their first career, and who consequently may not the more complicated insurance and retirement needs or knowledge of an older person or even know how to ask the right questions to determine their need.

In providing financial planning advice to clients to help them achieve their goals in life, it is incumbent upon a professional adviser to review their insurance needs as part of an overall plan. With respect to any kind of life insurance product, there are basic questions that a consumer needs to ask about the product, particularly since life insurance agents are not required to comply with practice standards.

Unlike on the securities side of the business, where NASD suitability rules come into play, or as an investment adviser, where you actually have a fiduciary duty to place the clients' interests first, the insurance agent has no statutory obligation to the customer for determining the suitability of the product to the individual's need.

Some of the questions that I, as a financial planner, ask my clients: First, is there a need for insurance? Life insurance is recommended to replace the earned income of the insured for the benefit of his or her family, to provide funding for financial and life goals that that income would have provided for, perhaps such as college tuition.

If a soldier is young and single, I am not sure a life insurance policy is necessary, unless he has dependents or aging parents who need help or is perhaps concerned about his own future declining health.

Second, if it is determined that there is a need for life insurance, how long is the coverage needed? Again, the answer depends on the age of the insured and their particular concerns, goals and financial priorities.

If there are small children, the insured probably would want to have coverage that would last until that child leaves home. A needs analysis would look at the family's circumstances, determine its annual needs and arrive at a lump sum that is sufficient to provide the required annual income to support that family if the insured died.

Generally, an insurance company will provide a death benefit of about 16 times an individual's annual income. Let's assume that a soldier is 30 years old and has been enlisted for 6 years, his income would be roughly around $30,000. He may already receive $250,000 of insurance, purchased at a reasonable price from the U.S. government.

Another $250,000 in 20-year term insurance with an A+ rated company could possibly be obtained for as little as $167 a year. And a $250,000 permanent universal life policy from a reputable company might cost $1,077 a year. In contrast, according to information provided FPA by this committee, a so-called "seven pay term" life insurance with a death benefit of just $29,949 has a premium of $900 per year.

There is a saying that if all you have is a hammer, everything looks like a nail; in other words, unscrupulous insurance salesmen who have only life insurance to offer will try to solve every financial issue with an insurance product.

A financial planner who must put the interests of their client ahead of their own considers what investment tools are most appropriate given the financial constraints and priorities of the client.

I feel compelled briefly to talk about other investment products marketed on military bases. Very often, an annuity accumulation fund is connected to the insurance policy I described earlier that generates a negative return in the first 2 years and has a 5 percent early withdrawal penalty during the first 10 years. I wonder whether information is adequately disclosed about the costs and lack of liquidity of this annuity, as well as the fact that the funds are not generally available prior to age 59.5 without additional penalties imposed by the IRS.

We are concerned about the marketing of contractual plans on military bases to less sophisticated and lower ranking members of the military. This type of fund has the 50 percent sales charge on the first-year contributions and it is seldom the best investment product for these members of the military.

The NASD imposes limits on mutual fund sales charges to 8.5 percent. But these charges rarely exceed 6.5 percent. And in my experience, civilians working with reputable financial advisers typically pay no more than 5 percent of the first year's investment on a mutual fund purchase, including systematic investment plans.

When our soldiers are convinced to purchase inappropriate and excessively expensive life insurance and investment products, it may mean that other financial needs go unaddressed. If these news reports are accurate and those who most need basic financial services to protect their loved ones and their futures are being taken advantage of by companies that are getting access to these men and women in the guise of providing financial education seminars, FPA believes it would be prudent for Congress to consider restricting the sale of contractual plans and granting states the authority to regulate insurance sales practices.

I thank you for holding this important hearing. FPA looks forward to working with the committee on this issue. Thank you.

[The prepared statement of Elizabeth W. Jetton can be found on page 112 in the appendix.]

Chairman BAKER. Thank you, Ms. Jetton.

Mr. Mercer Bullard, welcome again for your third time; founder and chief executive officer, Fund Democracy. Welcome.

STATEMENT OF MERCER BULLARD, PRESIDENT AND FOUNDER AND CHIEF EXECUTIVE OFFICER, FUND DEMOCRACY, INC.

Mr. BULLARD. Thank you. Thank you, Chairman Baker, Ranking Member Kanjorski, members of the subcommittee. It is again a pleasure to appear before you today to talk about these important issues.

Like this subcommittee, when reports of abusive sales practices and unsuitable investment advice on military bases were reported in July, I was appalled. But I cannot say I was surprised.

The abuses stem from a number of observable structural causes. And some of them are more easily addressed than others.

I am going to briefly survey what I believe to be the main causes of these abuses and suggest possible solutions. I will spend most of time talking about the one that I believe would be easiest to address through fairly simple legislation, and that is the most shocking abuse, which I find to be the amount and the structure of sales loads charged on certain investment products.

They are shocking because of the substantial losses that result from the excessive loads. But they are also shocking because the amount and structure have been expressly authorized by Congress. The Investment Company Act expressly permits sales loads on periodic payment plans of up to 9 percent.

This means that a $100 per month investment in a 10-year periodic payment plan would incur a total sales load of $1,080 on total investments of $12,000 over the life of the plan. What is worse is the act expressly permits sales loads to be collected on an accelerated basis.

These are the upfront 50 percent of the early payments that we have heard mentioned in this hearing already. And those are spe-

cifically permitted under the Investment Company Act under federal law.

The distributor can deduct, on that basis, half of every $100 payment until the entire sales load has been collected. This means that, for example, after 22 months and $2,200 in contributions, only $1,120 will have been invested. The broker will have pocketed $1,080, again compared to the $1,100 actually in the investment.

If the investor cancels the plan, the broker gets to keep the entire sales load. And the investor is left with a 50 percent loss.

The act mitigates this exploitive structure somewhat by requiring that investors may cancel the plan within 45 plans of receiving a notice that describes their cancellation rights. And then they receive the value of their investment plus the total commissions paid.

If the investor cancels within the first 18 months, they have the right to receive the value of the investment, plus a refund of the commission, less 15 percent of the gross payments made. So this means that even if the investor cancels after 18 months, he will still be obligated to pay a commission of $270 on contributions of $1,800 to an investment plan that he did not even keep for 2 years.

If the distributor agrees to spread the sales load deductions over 4 years and deduct more than average of 16 percent of the contributions during that time, it does not even have to make available that 18-month cancellation option. So in this case, the investor would pay 16 percent in commissions, instead of 15 percent in commissions, on the 18-month investment.

At least the investor is better off if he cancels after 22 months. In that case, he will have paid only $352 in commissions, as opposed to $1,080, again on only $2,200 in contributions on an 18-month investment.

What makes these rules particularly shocking is that the sales load limits for sales of mutual funds—and when I refer to mutual funds, I mean mutual funds not sold through periodic payment plans, because as you may know, mutual funds are usually the underlying investment vehicle of periodic payment plans—the sales load limits for mutual funds set by the securities industry is substantially lower than the standard set by Congress. Normally, the securities industry will argue for higher limits than legislators. But that is not the case in this situation.

Under NASD rules, as Ms. Jetton described, mutual fund sales loads cannot exceed 8.5 percent, with that limit being reduced in a number of situations where, as a practical matter, you can almost never charge the full 8.5 percent load. In practice, mutual fund sales loads rarely exceed about 5.75 percent. And there are some occasions in which, as she mentioned, they will reach about 6.5 percent.

More importantly, the load is deducted from contributions as they are made and cannot be accelerated. This means that if the investor cancels the investment, commission paid does not exceed 5.75 percent.

Compare that with a 9 percent or 15 percent or 50 percent commission paid by investors in periodic payment plans. To put the different treatment of mutual funds and periodic payment plans in perspective, if a mutual fund investor invests $100 per month in a mutual fund with a 5 percent load—and this will be typically

known, what is often offered as a systematic investment plans that most mutual funds offer—and they redeem the shares after 2 years, he would have paid $120 in commissions, compared with the $1,080 in commissions paid by the investors in the periodic plan—virtually the same investment.

If the mutual fund shareholder invests in a class of shares that charge a 1 percent 12b1-fee instead of a front-end load—the front-end load being the 5 percent front-end load—he would pay only about $25 in distribution fees, again compared with $1,080 for the investor in the periodic payment plan. The commission paid by the investor in the periodic payment plan is 4,320 percent of the commission paid by the investor in the mutual fund.

As you are well aware, the mutual fund industry has thrived, despite the lower limits imposed on sales charges. In fact, competition has driven down sales loads well below the limits imposed by the NASD.

There is no reasonable basis for subjecting periodic payment plans and mutual funds, which often offer their own systematic plans similar to period payment plans, subject to NASD limits, to different standards. I strongly recommend that Congress repeal the statutory restrictions on sales loads on periodic payment plans and direct the NASD to extend its rules to such plans.

This would be a deregulatory measure because it would shift to the securities industry authority for regulating sales loads on periodic payment plans. It would be more efficient because it would place the authority for regulating these sales loads in one place—that is the NASD—rather than two—the NASD and the statute. And it would be more flexible because the NASD would be in a better position than Congress to respond to changing business practices.

The other causes of sales abuses on military bases are also quite observable. But they are not nearly as susceptible to relatively easy solutions.

One problem is the inadequate and inconsistent regulation of investment advice mentioned by Ms. Jetton. The unsuitable recommendations made to military personnel are characteristic of the lower standards that apply to brokers and the even lower standards that apply to insurance agents.

Brokers who provide individualized investment advice often are not even regulated as investment advisers, pursuant to SEC positions, or subject to fiduciary standards. And insurance agents often are not even subject to minimal suitability standards.

Both categories of professionals are provided individualized investment and financial advice and, accordingly, should be held to a fiduciary standard of care. Most of the financial services industry is adamant, is adamantly opposed to being held responsible for acting only in their clients' best interests, even while they become less the sellers of products and more the purveyors of advice.

Congress should conduct a bottom-up review of the regulation of financial advice.

Another problem is the special vulnerability of military personnel, especially junior personnel, to abusive sales practices, whether such practices involve periodic payment plans, life insurance, home financing or any other retail product you can think of.

The isolated command nature of military life is a double-edged sword.

It creates unique opportunity for the government to protect our soldiers from abusive sales practices. But for salespeople, it provides the opportunity to more easily exploit unsophisticated investors.

Ideally, the military would regulate sales practices on military bases. But it is not well suited for this job, which is not its primary mission.

We would not ask the SEC Chairman Donaldson to direct the war in Iraq any more than we should seriously expect the Pentagon to be the most efficient regulator of financial services on bases.

But as long as the military continues to exercise some control over sales activities on bases, state and federal regulators will be justifiably reluctant to intervene and apply what may be a different set of rules and a different set of procedures. Congress probably should encourage the military to establish a central office for the regulation of sales practices on military bases. And that office should work closely with state regulators and the SEC to come up with consistent standards.

But even with such a structure, it will be difficult to enforce the same sales practices for the benefit of our soldiers as we do for our civilian population.

The broadest and last problem is that the financial services industry is regulated in a generally dysfunctional smorgasbord of rules, promulgated in force by a wide variety of state and federal regulators, each of whom takes a different approach to regulation and oversees arbitrarily defined product lines. The reports on sales abuses on military bases illustrate how this patchwork of financial services regulation compromises consumer protection, increases costs and suppresses competition.

Our system of financial services regulation is a drain on capital formation and wealth creation. Congress should begin a systemic review of financial services regulation with the goal of efficient, functional regulation of all financial services providers and products.

These are the essential problems I see underlying the sales abuses documented in recent reports. Some are fairly intractable. And I hope only that there will be some progress in addressing them during my lifetime.

But some can be effectively addressed in the short term. I would again recommend strongly that Congress shift regulation of sales loads on periodic payment plans to the NASD. This is a simple deregulatory step that would have an immediate, bottom line impact on our soldiers' financial security and help them benefit from the free market system that they are fighting to defend.

Thanks very much. And I would be happy to take questions.

[The prepared statement of Mercer Bullard can be found on page 78 in the appendix.]

Chairman BAKER. I thank you for your testimony.

Our next witness is Mr. David Woods, chief executive officer, National Association of Insurance and Financial Agents.

Welcome, Mr. Woods.

STATEMENT OF DAVID WOODS, CHIEF EXECUTIVE OFFICER, NATIONAL ASSOCIATION OF INSURANCE AND FINANCIAL AGENTS

Mr. WOODS. Thank you, Chairman Baker, Ranking Member Kanjorski, members of the committee. It is our privilege this morning to spend a few minutes with you, sharing our view of this problem and some of the solutions that we think might be appropriate.

I do represent the National Association of Insurance and Financial Advisers. We represent 65,000 insurance agents and financial advisers and another 150,000 of their employees across the United States.

The Life and Health Insurance Foundation, of which I am also the president, is a non-profit organization whose mission is to educate the public about the essential role of life, health, disability income and long-term care insurance in their financial plans and the value added by qualified and professional insurance agents and financial advisers.

NAIFA has worked closely with the Department of Defense and with Congress over many years to improve and to establish proper regulation of insurance sales on military bases, to improve financial education for these men and women, which many members of the committee have already established is of critical importance.

Let me start, however, by making it very clear that in our view, the vast majority of life insurance agents and financial advisers adhere to the very highest professional and ethical standards. And in doing so, we obviously condemn those who do not.

As our mission statement indicates, NAIFA's reason for being is: to promote professional, ethical business practices. Just as an aside and as a moment of personal privilege, I am sure Ms. Jetton did not mean to imply that those who are not members of the Financial Planning Association or who are not registered with the NASD are not ethical and are unscrupulous. In fact, as she well knows and all of you well know, life insurance—its policies, its marketing practices—are well regulated by every state and by insurance commissioners across this country.

All of us—Congress, the Department of Defense, NAIFA—we all have the same goal here and that is to educate military personnel about financial matters that are critical to them and to stop the deceptive and unfair sale of insurance products. We must be steadfast, obviously, in guarding against unethical and possibly illegal sales practices. And we believe that the importance of ensuring that military men and women have access to insurance products cannot be overstated.

As I indicated, the sale of insurance of course is regulated by both the federal government through the Department of Defense and the states, which are our nation's primary regulators of insurance. The current regulatory structure establishes a workable mechanism for the supervision of insurance agents on and off military bases and strikes a proper balance between guaranteeing the right of military personnel to have meaningful access to insurance products and financial education and ensuring ample protection for these insurance consumers from predatory sales practices.

The problem, however, with the current structure is the lack of coordination and communication between the Department of De-

fense and state regulatory authorities and the lack of adequate enforcement of existing rules. To correct these problems, in our view, the Department of Defense and the state insurance commissioners need to work together to develop a scheme to improve communication, improve coordination and improve enforcement of both Department of Defense rules and state laws.

We are delighted and we applaud Representative Max Burns for your efforts, sir, to provide solutions to these problems with the introduction of your Military Personnel Financial Services Protection Act. We enthusiastically support the proposal's embrace of state insurance regulatory authority by clarifying current law regarding state insurance regulatory authority over insurance transactions on military installations, which is certainly less than clear at the moment, as you have said.

The bill supplements the authority of base commanders and improves the ability of the Department of Defense and state authorities to ensure that insurance sales are properly handled.

We would, however, point out that there is some language in the bill which does cause some concern to us because it could be interpreted more broadly and lead to unintended and perhaps problematic consequences for the insurance industry and insurance consumers. And our statement gets into it in greater detail.

We would look forward to working with you, sir, and with the committee to refine the language so your intent is clear and it does not do some harm where it should not.

We recognize that the majority of military personnel are, like Special Conger, young, often have little financial background or formal financial planning education. This is true not only in the military, but in society as a whole.

We support the framework established under the directive by which military personnel can and do receive critical financial education. The Life Foundation, of which I am the president, provides crucial insurance-based financial information directly to a broad spectrum of society, including high school students.

In fact, we already provide educational programs and material to 25 percent of high school juniors and seniors throughout the country. The Life Foundation has offered and continues to offer—and do so here—to provide educational programs and materials that it has already developed to the Department of Defense for servicemen and women.

So in summary, Mr. Chairman, clarification of current law, improvements in communication, coordination in enforcement and financial education are all critical elements in ensuring that current laws work to provide military personnel with the consumer protections that they need. With these goals in mind, NAIFA and the American Council of Life Insurers developed a set of best practices, which we have submitted to you, for military sales and their functional regulation. And these are attached to our statement.

And thank you again, sir, for the opportunity and the privilege of appearing before you today.

[The prepared statement of David Woods can be found on page 146 in the appendix.]

Chairman BAKER. Thank you again, sir.

Our next witness is Mr. Frank Keating, president, chief executive officer, the American Council of Life Insurers. Welcome.

STATEMENT OF FRANK KEATING, PRESIDENT, THE AMERICAN COUNCIL OF LIFE INSURERS

Mr. KEATING. Mr. Chairman and members of the subcommittee, I appreciate the opportunity to appear today and to discuss how best to address unscrupulous sales of financial services, including insurance, to our men and women in the military service.

You are to be congratulated on conducting this expeditious hearing. We at the ACLI are glad that the revelations of this summer have finally opened communications among those whose responsibility it is to solve the reported problems.

For more than a year, the ACLI has been aware of such allegations of misbehavior. As a matter of fact, before the New York Times articles appeared, I personally met with senior officials of the Department of Defense to discuss this issue with them.

We have sought attention at the highest levels. Today, we have solutions we wish to share with you.

We believed we had achieved a breakthrough earlier this year when we were able to sit down with representatives of the U.S. Government Accounting Office to help them plan their investigation into the accusations leveled by all sides. We encouraged the GAO to dig deep beneath its express mandate to get to the bottom of things.

But it was the stories published by The New York Times in July that rocked everyone out of complacency and into remedial action. And it is about time.

The telling thing about the newspaper's stories is that the news was old news. Many of the same allegations involving the same companies were reported 4 years ago in the Cuthbert Report, which is the unofficial name of the official Defense Department investigation into "Insurance Solicitation Practices on Department of Defense Installations."

While that report itself is controversial, it was clear long before it was published that something was amiss in the supervision of insurance sales to military personnel. It should have been clear that alleged insurance problems required something of state regulators as well as defense officials.

Our military mobilization since September 11th accelerated personal financial planning for our newly enlisted, accelerated sales of insurance and perhaps accelerated incidents of coercive selling. But it did not accelerate communications between industry and defense officials and state insurance officials until now.

The ACLI and the National Association of Insurance and Financial Advisers—NAIFA—have shared with you for this hearing a dozen best practices for military insurance sales and their financial regulation. Our recommendations are divided into three areas.

The first addresses military installation market conduct by insurers and insurance agents. The second area recommends improved, standardized financial literacy opportunities for our servicemen and servicewomen. The third area recommends improvements in regulatory supervision of the military market for insurance sales.

Thus, we offer suggestions for improvement for both industry and regulators. We have more ideas to offer and we are actively soliciting suggestions from our member companies and agents.

We want to assure that our military servicemen and women have the education, information, safeguards and independent sources of advice necessary for their individual needs. No industry can endanger its fundamental enterprise by tolerating misconduct in its core activities.

We do not want our many good companies and agents unfairly tarred by a brush intended for a few. That is why ACLI is here today and anxious, on behalf of the companies, to help you sort out the regulation of military sales of life insurance.

We are convinced that the reason these issues continue to come up is because of the lack of clarity over who has the authority to oversee such sales and the absence of clear procedures to ensure the highest standards for dealing with men and women in uniform.

I might take a moment now to address remedial legislation drafted by Representative Max Burns of Georgia. I commend Congressman Burns for his authorship of this bill. I also commend Congressman Emanuel for what he has proposed.

At the heart of it is the genuine solution to many of the problems reported in the press: state regulation. That solution involves the realization of genuinely functional regulation in both the technical and common sense terms.

We support the overall concept of both bills. But there are a few ancillary provisions to which I would like to make some suggested improvements.

First, the Burns bill intends, we believe, to prohibit a particular investment product known as contractual mutual funds. As this is not a life insurance product, ACLI has no opinion about the pros and cons of such an investment.

However, the description of the product in the legislation goes far beyond contractual mutual funds to prohibit all kinds of insurance and annuities that have a variable element in them. ACLI has communicated with the committee staff on how to refine the technical description in the bill to the controversial product under your review.

My second observation is that the notion of asking 50 state insurance regulators to implement new standards to protect military personnel from insurance sales misconduct is unnecessary and probably unwanted by all the regulators involved. It has been the absence of any kind of functional regulation of insurance sales on military installations that has created cracks through which misbehavior has reportedly taken root.

Further, it is in the complete absence of effective enforcement of all relevant rules that has caused some of our soldiers to become victims of scams. Fifty new state rules in addition to existing rules will not better protect our servicemen and women if neither the states nor the Defense Department can enforce any rule.

The military services are a unique environment. It is populated by highly mobile individuals who have special needs and a healthy respect for those in authority or who otherwise provide guidance.

The functional regulation of insurance by the states must be reconciled with the functional regulation of our military personnel by

the Defense Department. We believe that the necessary balance can be achieved in two ways: first, by centralizing relevant financial services information for all military services within a particular command in the Defense Department; and secondly, by looking to that centralized defense command to serve as the liaison and coordinator of financial services sales supervision, the handling of complaints and regulatory assistance with the financial service functional regulators at the state level.

Under this approach, an infraction by a sales agent or a company on a military installation is not an isolated incident receiving an arbitrary evaluation. Rather, it becomes an incident reported to multiple regulators and multiple installation commanders.

It is subjected to fair and certain adjudication. And it will result, in some cases, appropriately in license revocations or penalties that sting.

The cracks in the system become sealed and misbehavior is rooted out, not to find fertile ground on another installation or in another state or foreign country. Ignorance breeds ignorance. If there is no ability for commanders to communicate or for regulators to communicate and to have this system put in place here in Washington to provide information, corrective action will never be taken.

Thank you, Mr. Chairman, again, for allowing me to address these important topics and ideas. We at ACLI are eager to help address effectively the problems under investigation by the GAO. We very much believe we can be part of the solution and that our recommended best practices provide a path to success.

Thank you.

[The prepared statement of Hon. Frank Keating can be found on page 120 in the appendix.]

Chairman BAKER. Thank you for your participation.

Specialist Conger, at the time that you were first approached by the sales representative for the American Amicable investment, do you recall whether the words "front loaded" were used or that there was any disclosure made about fees that you would pay in that first or second year or financial penalties that might be associated with any premature actions on your part?

What can you tell me, from your memory, about the presentation, when they said, "This is a good deal. This is what we need from you. And here is what you get?"

Did they tell you where your money was going to go when they asked you to make that check out?

Mr. CONGER. They did not tell us exactly where it was going to go. They showed us on charts pretty much how much money we would make. And they told us the sooner we put our money into it and if we decided later on to take it out, that there would be a very big penalty, very big fine.

And that is about all I know.

Chairman BAKER. Do you recall did they tell you how long you had to leave it in to avoid paying that big penalty? Did they tell you that?

Mr. CONGER. They said, at the time, we had to leave it in up to 2 years, I believe.

Chairman BAKER. 2 years.

Mr. CONGER. I believe.

Chairman BAKER. That is interesting. Okay.

Thank you very much, sir.

Mr. CONGER. Yes, sir.

Chairman BAKER. Ms. Jetton, a contract plan with a 50 percent first-year commission, as American Amicable provides, starting with a $900 premium for a $21,000 death benefit, is that a good deal?

Ms. JETTON. Well, in the civilian marketplace, just to give you comparison, if we are talking about term life insurance, someone of a young age could get $250,000 of term insurance for $200 or less.

We have two different things here and I think even we are getting confused at times. On the contractual mutual fund plan, where you have the 50 percent sales charge on the first year's contributions as Mr. Bullard and I commented, in the civilian marketplace you cannot charge more than 8.5 percent front-end load. And that comes out only as you invest new monies.

And typical practice is you do not really see front loads higher than 6.5 percent. And truly a very reputable financial adviser who is, by law, putting the interests of their client first, can find good quality investments in a commission front load product, where the commission might be between 4 to 5.75 percent.

Chairman BAKER. Well, let me state it a little different way, then. If you were sitting in the room with some of these young men and women, typically, as I understand the profile of most of the customers, they are about 24 median age, total annual compensation of about $30,000, very minimal net worth calculations not really any identifiable near-term financial needs because of their military obligation.

How does someone come to the conclusion that either of these products are professionally appropriate for their financial next step?

Ms. JETTON. Well, that is the question. I have met with young enlisted and officers in the course of my career and typically their primary concerns are living within their means, avoiding debt, having just some liquid reserves in a savings account to protect them from all the kind of uncertainties, such as a car breaking down or a child needing some medical attention. So I would in no way ever recommend this type of product.

What we are always looking to do is make their dollars stretch as far as we can to cover all of the financial issues that they are facing, both what they are facing today in their lives and, if there is a life insurance need, finding the most economically viable, quality insurance product possible with the highest death benefit that would be appropriate.

Chairman BAKER. Generally, I am just appalled that this level of advice was permitted to be given to frankly individuals who were not in a position or mental state to make judgments, in light of the exorbitant financial costs associated with the extraordinarily low benefit. I just keep looking for an explanation from somebody as to how this happens.

And apparently, it has happened to a great extent over a considerable period of time because there are several companies that appear to be doing quite well selling this product. I am advised that

this series of votes, commencing now, will be a series of three votes. I leave it to the gentleman's discretion whether we would like to just recess now and go for the votes, or would you care to proceed with your questions? If you would like to be recognized, sir?

Mr. KANJORSKI. Sure.

Chairman BAKER. I would recognize Mr. Kanjorski for his questions.

Mr. KANJORSKI. The testimony poses some disturbing facts. No one likes to see the armed forces, their personnel being taken advantage of. But it raises the other side of the issue on consumer protection generally and how far government and regulation should get involved, really.

It reminds me of a hearing the chairman participated with me several months ago in Monroe County in the purchase of homes and mortgaging and brokerage of homes. And the question was that people from the greater New York area were buying homes sometimes twice their value.

And as a result, once they purchased the home and they started to pay on their mortgage for a year or two and they went for a refinancing, they found out the value of their home was about half what they paid for it. And needless to say, hundreds of people either went into foreclosure or were very disturbed with that fact.

And it raises the question: just what should the role of government be in saving people from their own misjudgment or failure to exercise reasonable procedures in the marketplace? I keep thinking of: is Casablanca shocking, that there is gambling in the casino? Well, is it shocking that there is profiteering in business?

We are really going to raise the question here: just how much do we hold the hands of not only military personnel, but consumers generally? And what the constraints of that will be on the free enterprise system.

In an ideal world, I would like every member of the armed forces to have a financial planner. I would like to be certain that they do not get charged any greater amount than the median amount in cost of investments.

But the reality and the practicality of that is we are going to have to block the military from having any activities with financial transactions while they are in the service because invariably, unless we are able to write some sort of regulatory provisions or legal provisions that guarantee that we will stand behind the failure to use good financial judgment and I do not think it is possible to do that.

The question is: do you find—and maybe I should direct this question to Ms. Jetton and Mr. Bullard—do you find that the practices are so outlandish that the government should, in a very heavy-handed way, step in and restrict any participation except for those that are qualified to be absolutely foolproof to potential armed forces personnel? Or is this just the risk we take?

Mr. BULLARD. As a general matter, we should step in only where there is some evidence of market failure. And sales practices on military bases, I think, would clearly qualify.

It is a closed market. It is controlled by the Pentagon. It is highly susceptible to affinity marketing, which is another word for using relationships to exploit consumers.

And therefore, given that some degree of market failure, I think it is appropriate to think about stepping in.

But another answer to your question would be we already regulate and impose price restrictions with respect to sales practices. The reason we do that and not, for example, impose price limits on mutual funds themselves is that the potential for abuse in sales practices is so much greater.

You have someone who is very difficult to regulate on the ground, engaged in interpersonal reactions, where it is very hard to prevent sales abuses from occurring. And decades ago, Congress decided that it was appropriate to impose limits.

The mistake it made was that when it gave the NASD the ability to impose limits on mutual fund sales, it did not then also repeal the provisions for periodic payment plans and also send that along with the same package. So we have really answered the question as to sales loads.

They are regulated. They are regulated by imposing very specific restrictions.

But we have an archaic set of provisions that allowed accelerated payments that really would have gone by the wayside if the industry itself had been regulating these securities products. So I think the answer would be that in evidence of market failure and a long history of already providing those kinds of restrictions, that there is a very strong argument for having some more government oversight in this case.

Ms. JETTON. And I would agree. And I would also note that we do have fairly heavy-handed regulation in the civilian marketplace through the NASD and the SEC. And the military, in some ways, has been carved out as a niche, when in fact, it is probably an area that needs at least the same level of protection because of the very people we are talking about, who are so very often young, who are coming into it with a focus on serving their country.

And their lives are complex and chaotic as a result of that. And I think they need our very special care.

There is also a problem in that anyone can call themselves a financial planner in this country without having credentials. There is a credential, the Certified Financial Planner. There is a meaning to the term "investment adviser" that should mean—and does mean—that you are registered with the SEC and have a fiduciary relationship.

But unfortunately, those terms are battered around. And there is no statutory regulation there, so that anyone can just use the language and be the wolf in sheep's clothing.

And I am certainly not denigrating the insurance profession overall. But again, there is a difference in our regulatory standard and professional standard. There is not a fiduciary standard in place for insurance. And therefore, I think Congress has a role.

Mr. KANJORSKI. Are you suggesting a special regulatory entity for defense personnel, as opposed to a more broadly regulated entity?

Ms. JETTON. I am not necessarily making that case. We have had so little time to really consider the issue. But we would be happy to consider and make more comments.

Mr. KANJORSKI. Thank you.

Gentlemen, I just want to get to you for a second. Are you full of scoundrels in your industry? Or is this an aberration?

Mr. KEATING. No, our industry is not full of scoundrels. But I disagree with this nice lady. If you are selling a product, you may almost have a fiduciary relationship to the person to whom you are selling the product.

But let me say this, as you know, Congressman, bad facts frequently make bad law. We have to reflect, before we take action or propose action, that an 18-year-old in this country is an adult. An 18-year-old can serve in the military. An 18-year-old can enter into a personal property contract.

Mr. KANJORSKI. They do not vote very often though, governor.

Mr. KEATING. The same thing with real estate; the same thing with serving on a jury and sending somebody to their execution or to a prison term. So what we propose is to say, look, this is an unusual environment.

What we ought to have is a full, complete and utterly impartial financial services seminar for military personnel, because this is a family decision—their retirement, their savings, these are matters of real interest to them. It obviously is of real interest to the military: to not permit its people to sign unknowingly on the dotted line at those kinds of events. If there is a bad apple—and there are bad doctors; there are bad lawyers; there are bad insurance salesmen it is important to have that information provided to the Department of Defense, and shared among insurance commissioners.

There already is a system in place that can communicate, insurance commissioner to insurance commissioner, to all the agents and all the companies. So to bring together the regulators in an office at Defense and give the opportunity for base commanders to access that information so that they are not dealing with someone who has been booted off another base is readily available. I think it is rather simply handled.

But I think we do not need to patronize people. We need to give them the very best information and not permit abusive practices on bases.

Mr. BALLARD. Could I respond to one comment? It is factually and legally incorrect to say that sellers of life insurance have a fiduciary duty. They do not, never have. And Ms. Jetton is exactly right.

And the product you describe, Chairman Baker, would have been a violation of that seller's fiduciary duty. But because they are not subject to fiduciary duty, we have this issue in front of us today.

Mr. KEATING. That is not true.

Mr. BALLARD. We do not need to debate that.

Chairman BAKER. No, we do not. We are down to about 5 minutes on the vote. With everyone's tolerance, since there are two pending matters, I understand the second vote may now be a 15-minute vote, we will stand in recess until 12:30 to accommodate everyone.

Thank you.

[Recess.]

Chairman BAKER. I would like to call this meeting of the Capital Markets Subcommittee back to order. We will certainly have members returning, as circumstances warrant. But in order not to delay

our panel any longer, I wish to proceed in recognition of members for questions.

Mr. Kanjorski had been previously recognized prior to our recess. Mr. Lucas would now be in order.

Mr. LUCAS OF OKLAHOMA. Thank you, Mr. Chairman.

Governor Keating, you testified that ACLI had sat down with the GAO office to help them plan their investigation into the accusations leveled by all sides concerning military insurance sales. Could you describe to the committee a little bit the nature of some of those accusations and the inappropriate practices and then what ACLI's suggestions were to the GAO in regards to that?

Mr. KEATING. Congressman Lucas, as I alluded to in my formal testimony, I came aboard just after the first of last year, mid-January. And one of the first letters I wrote was to the Department of Defense after we heard about allegations of oppressive sales practices and inappropriate products being sold, asking for a meeting with the Department of Defense.

That meeting was declined. In the course of the inquiries from GAO, we have taken up with them these issues, as recently we did with the Department of Defense in a meeting with them. We have subsequently had a meeting with officials from the Department of Defense and taken the position that the answer must always be a regulatory scheme that works.

And it is very difficult if a state insurance commissioner who has responsibility over life insurance sales does not know about an accusation. It is very difficult for that insurance commissioner to take action against either the company or the agent.

It is particularly difficult for the company if they do not know that there is a problem on a base with a particular agent. So with the GAO, as well as with the Department of Defense, our position has consistently been a clearing house at DOD, with access to the computerized information of all the agents and companies in the country.

Let's say an agent acts improperly at, let's say, Fort Sill in Oklahoma. That individual should not be able to just go on to Fort Lewis, Washington and begin business as usual because his name, the fact that he has been excluded from the base, would be in this national system, accessible by the Department of Defense, by state insurance regulators. And not only can action be taken by the department in the barring of that individual, but also the license can be suspended by the insurance commissioner.

The problem has been, as I indicated, there really has been no communication or very little communication. And we are representing the companies involved—some 400 life companies, most of whom do not do business, by the way, on military bases.

So we are very anxious and insistent that there be communication between the Department of Defense and the state insurance regulators, a consistent system of sharing information and taking action when those bad apples and actors do surface.

Mr. LUCAS OF OKLAHOMA. Understood. And clearly, in that kind of a scheme, situation, regulatory regime, where the state insurance commissioners were involved in the regulatory process, if there was a problem with a company, with an agent, it would be possible for the insurance regulators surely to report to the base

commanders that those entities are no longer licensed to do business in that state, I would think.

In the long haul, governor, do you think that this is a situation that, granted it is a limited number of companies perhaps that specialize in this kind of a business, but is it a situation, based on your insights, you think, that has been a problem perhaps at a number of military bases across the country, as opposed to just a limited number of isolated incidents?

Mr. KEATING. I only know, Congressman, anecdotally, because again there has not been a universal sharing of accusations and information. But certainly the information provided in the New York Times pieces would suggest there were more than just a few bases involved.

And that is why the timeliness and the urgency of action is upon us. And to the extent that we can make sure that bad actors are identified and removed by the companies, to the extent we can make sure that bad actors are identified and either fined or removed by insurance commissioners, we need to do that.

And as you well know, as long as life and casualty and medical insurance are state regulated, you are going to have a wide variety of interest in these things. But if the Department of Defense can collate the information and share it with the insurance commissioners and become the bully pulpit to insist that action is taken in a public way, I think you are going to see this problem moderate very dramatically and very quickly.

Mr. LUCAS OF OKLAHOMA. Thank you.

Specialist Conger, thinking back to the information that was made available to you, how much time was spent by anyone for that matter discussing the various options that could be available to you, all the way from buying savings bonds on down to not participating in things. How much time would you say, in your military experience, was actually devoted to this kind of information providing? Guesstimate?

Mr. CONGER. Congressman, I would say probably about three hours. There was a discussion on investing money into mutual funds and the options. There really were not any other options that they gave us.

They kind of hurried us up in this situation and never really gave us any options or anything.

Mr. LUCAS OF OKLAHOMA. Thank you, Specialist.

Thank you, Mr. Chairman, for your time.

Chairman BAKER. Thank you, sir.

Mr. Scott, did you have questions?

Mr. SCOTT. Thank you very much, Mr. Chairman.

We are missing somebody at this hearing and that is the military. We have private insurance companies who are being given access to U.S. military bases, to sell young Americans in uniform expensive insurance that they do not need. And they are charging our soldiers high fees for investments that have been disgraced and outlawed in the civilian market.

And because these insurance salesmen have been given the military's permission to sell such products on their bases, many of our soldiers, like Specialist Conger, believe the products have their commander's stamp of approval. And we are having this hearing to

come to a way to fix this problem. And we do not have a representative of the Pentagon or the military here.

And I was just wondering, Mr. Chairman, if you could share with us: were they invited? Is there any reason why they are not here? I do believe that they are an important part of getting to the core of this issue.

Mr. Chairman?

Chairman BAKER. I am sorry, I was not listening.

Mr. SCOTT. My question was: did we invite the military here? I was very concerned that we have a problem that expressly happens in an environment that the military controls, been happening for 30 years, being perpetrated by agents who themselves are retired military and by companies on whose boards the military is highly represented. And here we are, trying to come to a solution to this and the military and the Pentagon is not here to answer questions before this committee.

And I wanted to know: were they invited? And if they were, why did they not come? And certainly, I would certainly want to make the case that before we move further to try to come up with answers to a problem, we certainly need the input of the defense and the Pentagon here to help us with this.

Chairman BAKER. I certainly understand the gentleman's concerns. The military would be the second tier level of concern, at least from my perspective at this time.

This is a free enterprise product, marketed through the approval or permission of the military administrations who allow a product to be brought to the attention of enlisted personnel for the enlisted personnel to be able to make independent financial decisions. However, it is clear to me, given the manner by which the marketing was conducted through retired officers to enlisted personnel in happy hour environments, that it was not a judgmental circumstance in which personnel could exercise independent financial judgments.

Therefore, at the appropriate time, I assure the gentleman that we shall engage military personnel responsible for authorization to explain to us their review processes. Now military personnel who allow private vendors on to military bases can not always be held accountable for unprofessional conduct.

If a private vendor was to come on to a military base with vending machines that took quarters on every occasion, that would not necessarily be an oversight of military personnel. However, given the longstanding practice, the excessive charges, the limited benefit, the reported incidences in which individuals reported their unwillingness to participate, there will be a requirement to have some thorough explanation as to how this practice and methodology was continued on such a longstanding basis.

But to the military's defense today, they were not extended an invitation to appear. We, rather, chose to focus on the financial aspects as a consumer product first.

Mr. SCOTT. Okay, Mr. Chairman. I certainly look forward to an opportunity, at the appropriate time, that I might be able to ask the military and the Defense Department.

Chairman BAKER. Oh, without question, the gentleman will reserve that right.

Mr. SCOTT. Let me ask Mr. Bullard, in your opinion, can you explain to me how contractual mutual fund plans are better suited for the military when it is almost non-existent in the civilian market? And are these insurance products commonly sold by other firms?

Mr. BULLARD. The contractual plans you are talking about, I assume are the ones through which you can charge up to the 9 percent sales load and deduct the sales load, up to 50 percent of each contribution for the first couple of years. And those are not sold in the civilian marketplace simply because they cannot compete with other mutual fund products.

In the civilian marketplace, you have an open marketplace. There is a great deal of competition and information out there. And it is for that reason only are periodic payments that sell mutual funds not sold, but even mutual funds competing for business set their sales loads at levels that are substantially below what is allowed by the NASD.

So the obvious explanation is competition, which leads me to look at the military base environment and, not surprisingly, find a lot of examples of why the markets are not working efficiently. You have a command structure, which lends itself to officers and enlisted personnel who are vulnerable to influence by senior officers, senior retired officers.

You have an environment where you have a selective group of persons who have access, thereby creating high barriers of entry to that market. So there are a lot of market reasons why this is probably a fairly inefficient market and additional regulatory scrutiny is needed.

Mr. SCOTT. All right.

Governor Keating, let me ask you this. Are you familiar with First Command Financial Planning?

Mr. KEATING. Only from the news reports. That is correct, Congressman.

Mr. SCOTT. Only from the news reports?

Mr. KEATING. Yes. They are not a member of our association.

Mr. SCOTT. What about American Amicable Life Insurance Company?

Mr. KEATING. From the news reports as well.

Mr. SCOTT. They are not a part of your organization?

Mr. KEATING. They are.

Mr. SCOTT. They are?

Mr. KEATING. Yes.

Mr. SCOTT. Pioneer American Insurance Company?

Mr. KEATING. No.

Mr. SCOTT. A part of, I think, our task here is, as I see it from the enterprise standpoint and our oversight of coming up with legislation, is: how do we get at the bad actors here? And can you share with me your experiences with trying to get any assistance on this?

And secondly, and perhaps Mr. Woods too with his organization that comes I with the insurance, were there any bureaucratic barriers in your way? And if you could give to me what was the genesis of the GAO investigation?

Mr. KEATING. Well maybe Mr. Woods can comment about the GAO investigation. But I can say that when it came to my attention—and ACLI represents about 400 life insurance companies, most of whom do not do any sales on military bases—but this was a challenge to our franchise, the ethics and integrity of the institution of life insurance and life products.

So I contacted by letter the Defense Department and asked for a meeting so we could discuss: what can we do to make sure that bad actors and bad companies do not misbehave on military bases and take advantage of young and frequently uninformed military servicemen and women? Their information back, their response back was, "We cannot meet with you."

Now as a result of the passage of some months and even before the New York Times article appeared and some additional efforts to try to have them meet with us, we did meet with them. We explained that it was very difficult for a company to know if they have a bad agent if the base commander and/or the Department of Defense do not share that information.

And the response back was, "Well, FOIA." And you know, a lot of things in the FOIA exchange are redacted. It is difficult to find out: what did go on here? Can I really fire this person?

So that is the reason we have been insistent, Congressman, from the start, that there be transparency—very much like the Emanuel bill, quite truthfully—that there be transparency, full sharing of information and a proactive role on the part of the Department of Defense to make sure that the agents and the companies doing business—because banks, securities firms and life companies have been on bases for many, many years and they are, in fact, not abusing, and not taking advantage of servicepeople.

This is a $3.5 trillion industry, an extraordinarily important industry to America, to our economic vitality and success. We want to make sure that only good men and women are in it and particularly only good men and women are on military bases.

So I think, from my standpoint, the thing that was frustrating to me was on the Department of Defense's reaction. It was not as urgent as it was to us. But again, we represent the industry. And we felt great urgency to address this problem.

Mr. SCOTT. Do you think that these companies that I mentioned, that throughout this whole investigation or research we have been doing, appear to be repeat offenders of this, like Amicable, First Command, those companies? Do you think companies themselves who engage in this should be banned from the military bases?

Or do you see this in terms of bad actors, as rogue agents? Do you see them doing it on their own? I mean, it is hard to think that——

Mr. KEATING. Again, Congressman, all I know is anecdotal. And the companies or several companies are here to answer your specific questions about your specific concerns about conduct, practices or sales.

But the reality is there is authority in every state to take action against bad companies and bad agents. And just as I indicated, we have bad lawyers, bad doctors, bad siding salesmen in this country. And you need—we need—to take action against them.

Chairman BAKER. Mr. Scott, we have been quite liberal, but you are well over your time.

Mr. SCOTT. And I appreciate your generosity, Mr. Chairman.

Chairman BAKER. Thank you, Mr. Scott.

Mr. Emanuel?

Mr. EMANUEL. Thank you, Mr. Chairman.

I think what would be helpful is, rather than mixing up mutual funds or contractual mutual funds with life insurance products, we kind of separate the two. And even though the legislation puts the two together, there are actually a different set of problems and a different set of solutions, number one.

And I think on the contractual plans, what I find interesting through—and I will make one observation, at least as I understand what you said, Mercer, and if I got it wrong, I apologize for the characterization—is that there is not enough of a marketplace, so you had one product driving through.

And I think, on the insurance side, you have in a weird way too much competition and not enough information. And therefore, people are buying the wrong products. So they have different problems associated with them. That is number one.

On the contractual mutual funds, given this product is not in the civilian market and given it is not part of the general public, we should approach and try to wean it out in the same way—not wean it out, either end it and eliminate it, as my legislation calls for, or give a clear warning to all the men and women in uniform of how this product is perceived by the SEC, so it is unambiguous in the understanding for any consumer.

So if they want to buy it, there is what I call a surgeon general label on it from the SEC. "This is absolutely looked down upon, frowned upon. We do not think this product is good."

Now I think we should ban it. But if, for whatever reason, we cannot get ourselves, like the prior Congresses, to ban it, put a clear warning on it with all the red, flashing lights so everybody knows what that is.

And then maybe we should deal and look at further, as people want to look at mutual funds or other types of investment vehicles, of how we can get those products out.

But the learning lesson on the insurance side is: one, although the Defense Department seems to come for some criticism, I would like to come to at least one note of defense. We actually provide a product, the $250,000 life insurance product, that is a good product at very cost-effective basis.

And what should be done—since nobody else will tout my legislation, I will do it—is raise that ceiling to $500,000. I do not think the insurance industry would have a problem if the government was doing that.

And give people the option of $250,000 or whatever other breakpoints they want to make, but up to $500,000. Ninety-six percent of all people in uniform are in that insurance product, as I think I got that statistic right.

And then allow people in the private insurance industry to sell different products, niche products. So obviously you would tailor these on a customer-by-customer basis and inform them, which leads me to my question to Governor Keating.

What do you think is the knowledge basis—and again, you are not on the base knowing, but through your associated firms—the knowledge basis on some of the servicemen and women? If one product is being sold something like a savings plan, but it is really a life insurance policy, et cetera, what is the knowledge basis that they know of what they are buying and what they are purchasing?

What is the knowledge basis of what they think they need going in? And what can we do?

We have a general public problem of information, knowledge, et cetera. They are not there to be trained on financial literacy. That is not what they are there for.

So what can we do to make this easier? They can do what they need to do for themselves and their family? What knowledge basis do they have?

And then I have one other statement after that.

Mr. KEATING. Congressman, many years ago, when I became an FBI agent, we had a session in the course of our training about retirement and savings and all those things. But we were 22 to 25, 27 years old. And we did not care about it.

So everybody sat and listened. But how much really was absorbed was anybody's guess; probably not very much. Perhaps people who had children and families absorbed more than those of us who were single.

I think a similar challenge exists with respect to military families and military singles. The reality is that the military is a family, just like in my service in the Bureau, it was a family.

And they cared about us to make sure that if anything happened to us, our families were taken care of. And we should have listened more.

And in their case, they had a very transparent, very broad, very open information. Here are the things you need to think about; here are some of the solutions out there.

But in the FBI no one signed on the dotted line. And there was not a salesman who made the presentation. It was a series of professionals that did not try to sell us anything.

And I think to take, like Specialist Conger's example, enlisted men, single people, men and women with families and say, okay, you have so many dollars in pay. You can buy a little bit more insurance, a lot more, or another $250,000. You can buy even more coverage than that, a half a million dollars worth.

But if you do not have any kids, you probably do not need that. If you have children, you probably need that coverage or perhaps more.

Here are some thoughts that you need, with respect to mutual funds or retirement products or savings products to best secure you and your family's security. Openness, transparency, and full information about the product. Then let adults make decisions for themselves and not be bludgeoned or coerced into a decision by a superior officer or a superior enlisted man.

If you can do that—and I think it can be done—then I think you virtually solve the problem.

Mr. EMANUEL. I think that I am sympathetic to your case as a 27-year old young enlisted in the FBI. My wife accuses me of hav-

ing the adult version of ADD. I am sympathetic to that attention and what people had.

I do think one of the things that we can do in this legislation is clarify the role of the Defense Department, the commanders on the base, et cetera, so it does not look like they are blessing, encouraging or directing enlistees to sign up for something. So as the hosts, we may be sending an ambiguous if not—I do not want to say duplicitous, that is not exactly the right word—a message that should not be sent by encouraging people.

I do think one of the solutions is allowing the government to offer more life insurance than the $250,000 cap. That would be an opportunity so those who think they need more can, purchase more. They do it at a very cost effective basis.

The second thing we need to do at the Defense Department is set some clear guidelines so they do not write their own rules that give ambiguous messages to the enlistees of what they are or are not doing, are or are not saying. But the most important thing is to get to the contractual mutual funds and not allow $15 billion to exist.

And one last thing is then on the variable, as my legislation does, it grandfathers those in so we do not hold people and harm them in the process of making a transition.

Mr. KEATING. Congressman, looking at your proposals only of course in very summary form, those make a lot of sense. Congressman Burns' bill makes a lot of sense: to provide a regulatory apparatus, a sharing of information and a role for the Department of Defense to make sure that servicemen and women are not taken advantage of.

And particularly, I believe in your bill, where you literally sign a statement that there is no requirement that you buy a certain product or that there is no encouragement that a particular product be purchased. And I think that is sound public policy.

Mr. EMANUEL. Just because it is sensible, we would not want that to get in the way.

[Laughter.]

Thank you, Mr. Chairman.

Chairman BAKER. Thank you, Mr. Emanuel.

Mr. Burns?

Mr. BURNS. Thank you, Mr. Chairman. I appreciate the input from the panel.

We have a tough challenge and a difficult problem. Let me start first with Specialist Conger. Thank you for your service. Thank you for being a part of the 82nd Airborne. I spent a little bit of time at Fort Bragg and crawled around those hills a bit.

Can you give me—just a simple question—the allotment that you signed, how much per month did you have withdrawn?

Mr. CONGER. Congressman, I had $100 withdrawn a month.

Mr. BURNS. Was that fairly typical?

Mr. CONGER. Just about everybody in my platoon that signed up for it had about the same amount of money.

Mr. BURNS. Just about everybody?

Mr. CONGER. About 45 percent of everybody in my platoon.

Mr. BURNS. Okay. And how long was that allotment withheld?

Mr. CONGER. I would say——

Mr. BURNS. Eighteen months?

Mr. CONGER. I believe about 18 months.

Mr. BURNS. And again, the challenge that we face is when you agree to have your pay reduced and diverted, you were unfortunately not aware of what that was going for. Is that a fair statement?

Mr. CONGER. Yes, Congressman.

Mr. BURNS. Okay.

Ms. Jetton, in your testimony, one of the statements that you made is that contractual plans are seldom—seldom—the best investment product for these members of the military. Can you identify times when perhaps they would be?

Ms. JETTON. I think the positive that those plans are trying to address can be accomplished in other ways more efficiently; and that is, encouraging people to invest over a long period of time, to save money. And that is a wonderful thing to encourage.

But it is not necessary to encourage it at such a cost in the early years when folks are struggling to meet other financial demands. In any mutual fund you might purchase, mutual fund companies may at no additional cost have automatic drafts withdrawn from one's checking account.

So very often in our practice, we will encourage an individual to do a savings plan of $100, $200, whatever they can afford, on a regular basis. They can turn that spigot on and off at any time with no consequences. And again, they will pay a lower sales charge of typically no more five, at most 6.5, percent, only withdrawn as they make those contributions.

So I really cannot think of a time when there is not a better alternative that can accomplish the goals that these are apparently designed to address.

Mr. BURNS. I appreciate the certified financial planner's willingness to help in the education process, the counseling process. As an individual, if I were to ask you to evaluate my financial position and develop a plan for me, what kind of a challenge would that be? And how much time or how many dollars might that require?

Ms. JETTON. Congressman, it would depend. Different financial planners work in different niches. And we tend to work with middle class. We have a structure where we may work on an hourly basis with those who are starting out and charge $100 an hour, just for advice.

We have a signed engagement that every client would sign, that is basically outlining the scope of the relationship. In other words, it would say: this is how I am compensated. You do not have to buy anything from me.

But if you do, this is how I might be compensated. If I am working with you hourly, we can only cover so much, so be warned that I may not have a chance to address these issues.

So it is very clearly defined. And that is one of the steps of the financial planning process that all certified financial planners must abide by, is first of all outlining the scope.

I might also work in an engagement that is an annual fee, where it is almost carte blanche service for an individual. Other financial planners may receive commission as a way to be compensated for their advice, but they make that very clear.

I guess the point I would make here is that full advance disclosure is a requirement. And that disclosure includes specifically how you are compensated.

So if it is a life insurance contract, exactly how much percentage. If it is a term policy, it is not unusual in the first year to be paid 90 percent of the first year's premium.

But in the case of a certified financial planner, that has to be disclosed. The actual dollar amounts and how you will be compensated must always be disclosed in advance of any engagement.

Mr. BURNS. Okay, thank you.

Mr. Bullard, in your testimony, you were comparing maybe the Investment Company Act with the statutory Section 27 requirements versus the NASD Rule 2830. Is the solution to adopt NASD Rule 2830?

Mr. BULLARD. Well, I think the problem that we have with periodic payment plans is that they are periodic, it is that you can accelerate the payments, as Ms. Jetton was talking about. And it is the Investment Company Act that expressly authorizes that.

And it is for that reason, if I were the NASD, I would not want to touch the regulation of that issue because of the obvious conflict with federal law. So by repealing that provision, what you would do is you would let the NASD step in and apply the same kind of analysis they apply to mutual funds and probably arrive at the same results, which is to have similar regulation.

So I think it would be preferable, instead of Congress trying to continue to be in the business of trying to regulate with specificity the exact charges that can be imposed on a product, which is not what I think Congress is best at, instead to let the self-regulatory organization that knows the product well, is down there at the grass roots level, to take on that responsibility, which really should have been done back in the 1970s when it took on responsibility for mutual funds.

Mr. BURNS. Should contractual plans be eliminated?

Mr. BULLARD. No. I think that if contractual plan means the ability to sign a contract whereby you would have an amount deducted on a periodic basis and commit to that, that is a wonderful product. That is a great thing and is ideally suited for someone like Specialist Conger.

The problem is if he put his $100 a month in a mutual fund that was under the kind of sales load I described, they take $50 out of that $100 and put it in the broker's pocket. And he only gets $50 invested.

If he invested in a mutual fund with a 1 percent 12b1-fee, he would pay seven cents instead of $50.

Mr. BURNS. Right. Specialist Conger unfortunately was not involved in a contractual plan.

Is that correct, Specialist? You were involved with a product that supposedly was a mutual fund, but in reality was an insurance policy. Is that a fair statement?

Mr. CONGER. That is correct, Congressman.

Mr. BURNS. And the value, the face value of the insurance policy was? For that $100 a month, you finally got a copy of it after repeated attempts. But the face value was, do you recall?

Mr. CONGER. Around $2,000, Congressman.

Mr. BURNS. Wow. Okay. Now I think we have two problems and we are just trying to differentiate. But if I understand, Mr. Bullard, correctly, you feel that the NASD Rule 2830, if it were allowed to be appropriately applied, could help the problem?

Mr. BULLARD. Right. I imagine that what the NASD would do would be to eliminate acceleration of payments and subject the sales holds on period payment plans to the same 8.5 outside limit and the other provisions as well.

Mr. BURNS. Okay, thank you.

I appreciate NAIFA and ACLI's input. And I appreciate their willingness to work with the committee and the Congress in helping resolve this problem because I think we all share the same goal.

We want to make sure that our men and women in uniform and that serve our nation receive the highest quality financial products and the best investment advice and the best insurance advice. And to my good friend, Mr. Emanuel, I am delighted to know that his ideas are well received. And we will work together to find opportunities to craft legislation.

This committee has been exceptionally helpful in not only providing the hearing, but in addressing the issue that has, for years, been unfortunately ignored. And we do have some challenges in the Department of Defense. And I do agree that we need some kind of a mechanism for the monitoring and reporting and management of those who might abuse their privileges on one base, to make sure that they do not just go to a different base or go to a foreign installation.

So I think all of those things are challenges that we can address within the legislation that I have proposed or within the legislation that will come out of the discussions we are having today and other members' input. And I thank the chairman for the opportunity to be here and yield back.

Chairman BAKER. I thank the gentleman. There being no further members for questions for this panel, I want to express to each of you my appreciation for your patience and participation today. It has been most helpful.

The hearing today is certainly not the conclusion of our work on this matter. But your testimony has been most helpful in taking us to the next step.

The committee does reserve the right to have additional questions forwarded to each witness within an additional 5 days. Thank you very much. And this panel is dismissed.

Mr. CONGER. Thank you, Chairman.

Chairman BAKER. I would like at this time to proceed with our second panel. We have appearing with us today: Mr. Lamar C. Smith, chairman and chief executive officer, First Command Financial Planning, Incorporated; and Mr. Joe W. Dunlap, executive vice president, operations, American Amicable Life Insurance Company of Texas.

And I do wish to extend to you my appreciation for your willingness to appear. Others were asked to come today and had scheduling conflicts.

Under our normal committee procedures, you are encouraged to make your statements within a five-minute period. In light of the

number of members actually participating at this time, certainly liberties will be given on that. But your full statement will be made part of the official record.

Mr. Smith, please proceed as you wish.

STATEMENT OF LAMAR C. SMITH, CHAIRMAN AND CHIEF EXECUTIVE OFFICE, FIRST COMMAND FINANCIAL PLANNING, INC.

Mr. SMITH. Thank you, Chairman Baker. I am Lamar Smith, chairman and chief executive officer of First Command Financial Planning. It is my privilege to lead this 45-year-old company, which is 100 percent employee-owned. I have been with the company for 29 years and served at most levels within the company.

We are the largest provider of financial plans to the military families in the leadership ranks. We currently serve 305,000 client families including 129,000 who are still on active duty. We only recommend products offered by the leading insurance and investment companies.

I would like to address three issues in my statement today. First, I want to correct certain misimpressions about First Command. These misimpressions have been continued here this morning in the testimony and in the questions.

First Command is not the company recently portrayed in the media. In fact, First Command has been a leading voice for reform and improvements within our industry. And we renew that call today.

Therefore, in my second point, I would like to highlight four reform recommendations that we detail on pages five and six of our written statement. Several of these proposals are extensions of recommendations we presented last year at a Defense Department public forum.

Third, I want to comment on the systematic investment product known as "contractual plans," which is a subject of today's hearing. Please allow me to commend the members of the committee for investigating sales practices that target junior enlisted servicemembers with questionable financial products.

At the same time, let me take a moment to ensure there is no further misunderstanding about First Command, information which is outlined in greater detail on pages two and three of my written statement.

Please listen carefully.

First Command does not solicit business from junior enlisted servicemembers. We serve the military's leadership ranks of senior sergeants and petty officers, warrant officers and commissioned officers of all grades, including the flag ranks.

Unfortunately, the recent press reports confused this point. And there has been a great deal of confusion in the marketplace and this morning in this hearing. And I call on members of the press who are here present to straighten out that misunderstanding in any reports going forward.

Further, First Command does not recommend life insurance for savings or investment purposes. First Command does not sell at mandatory formations.

We are honored, as the market leader, with a 20 percent market share. Further, 90 percent of our clients recently surveyed said they would recommend us to their peers.

We take our mission as a company seriously, serving those who serve all of us in the defense of freedom and democracy. Keeping faith with this goal is our highest priority. That is why, as detailed in my written statement, we are proposing the following four recommendations to help address some of the matters before this panel.

One idea: require junior enlisted personnel to meet with a specially trained independent counselor from their installation prior to enrolling in a financial product affecting their pay. Secondly, create a centralized DOD registry of agents and the companies that they represent to identify trends and any unscrupulous practitioners.

Thirdly, require companies to provide lapse rate date, which refers to the rate at which purchasers on average terminate a given financial product. A low lapse rate indicates the marketplace values a product and receives a benefit from it. A high lapse rate indicates the contrary.

Concerning contractual plans, we support extending the period of time from 18 to 36 months in which a purchaser can terminate a plan and receive a substantial refund of their sales charges. Further, the portion of the refund should be increased.

This brings me to my final point, a further word on contractual plans. These plans are only recommended to investors who have long-term goals for wealth accumulation, such as most of our clients, who will likely enjoy many years of steady employment.

Critics have implied that contractual plan customers are somehow locked into these plans. No one is locked into them. The contractual plan purchaser can terminate his plan at any time.

Since we are here to seek ways to protect and serve military families, I would like to read a few passages from letters we have received from our clients very recently.

First letter, just a passage, that is written by a military wife: "I firmly believe in their systematic programs for making payments to my investments. If they had not made it so easy to do my investments through systematic monthly payments, I would not likely have any kind of retirement plan."

A passage from a second letter: "Looking back over the 11 years of our association with First Command, Frank and I have moved from being essentially newlyweds with no plan for our financial future to now. Frank is a colonel approaching retirement. And we are within a few years of complete financial independence."

"It is amazing how far we have come in little more than a decade. We both consider the discipline required by our systematic investment plan as the key to that remarkable progress."

Another letter: "I have been so pleased with the programs that First Command developed for me that I referred both my sons to them. Both boys are in their mid-20s and have started systematic investment plans recommended by First Command, so they too can be financially prepared for retirement."

And lastly: "In the 12 years we have been clients, we have been relocated nine times." That is very typical, by the way, in today's military. "Always, it has been a smooth transition with First Com-

mand. And we have never been without a representative to help us answer questions."

"We believe that it is a great company. And we are thankful for their guidance and support."

We believe these statements are common among our clients. I do look forward to answering your questions. And I want the distinguished members of this panel to know that First Command stands ready to work with you and to support whatever course of action Congress takes.

Thank you.

[The prepared statement of Lamar C. Smith can be found on page 129 in the appendix.]

Chairman BAKER. Thank you very much.

Mr. Dunlap, proceed at your leisure.

STATEMENT OF JOE W. DUNLAP, EXECUTIVE VICE PRESIDENT, OPERATIONS, AMERICAN AMICABLE LIFE INSURANCE COMPANY OF TEXAS

Mr. DUNLAP. Chairman Baker and members of the subcommittee, thank you for the opportunity to appear before the committee today. My name is Joe Dunlap. And I am here on behalf of the American Amicable Life Insurance Company.

I have worked at American Amicable for 26 years and have served as executive vice president of operations for the past 1.5 years. Prior to that, I served as vice president of policy administration for 18 years.

On behalf of American Amicable, I would like to commend the committee for holding this hearing today. We believe that our company—and, more importantly, our customers—benefit when all salespeople and agents from all companies selling financial and insurance products and services comply with the applicable rules and regulations.

We also support all reasonable efforts that can be made to provide additional financial education opportunities to military personnel to help them make informed financial decisions for themselves and their families.

We believe that those who have a high level of understanding about our products and the other financial and investment products sold within the military bases will benefit substantially.

On behalf of American Amicable, I also want to commend Representative Burns' and Representative Emanuel's legislative proposal and to say that we support the insurance provisions as we understand them today, including a stronger role for the state regulators in regard to on-base military sales. American Amicable does not sell the other investment products that are addressed in the proposed legislation

Our company, American Amicable Life Insurance Company of Texas, dates back to 1910. Today, it is part of the American Amicable Group, a nationwide company that provides benefits and protection to over 180,000 policyholders.

We sell life insurance. We do not sell mutual funds.

The majority of our military business today is sold off-base. And one-third of our Horizon Life policyholders are civilians, not military.

Over the past 20 years, the group has paid more than $428 million in death benefits across the full line of business. Last year alone, we paid $8.2 million in death claims on policies issued in the military market.

To date, we have paid nearly $1.5 million to beneficiaries of servicemembers who unfortunately lost their lives in Iraq. We are proud of the service we provide to our customers, including many members of the U.S. military. But we are not proud of the conduct of the agents who sold our products at Fort Benning and Camp Pendleton in a manner totally inconsistent with our compliance policies.

While those agents constitute a small percentage of the nearly 3,000 independent agents who are authorized to sell our products, there is no excuse for their conduct. It is inconsistent not only with our standards and policies, but with the certifications we require our agents to sign, pledging compliance with all military, state and local regulations.

I want to assure you that we take these matters very seriously and expended a considerable amount of time, resources and effort to investigate these matters and take corrective action, to include terminating the agents that were involved, terminating their contracts, offering full refunds to all affected policyholders, developing new and improved compliance programs, including a new agent audit system that includes surprise inspections of field agent offices that we believe will make us an industry leader in compliance.

And further, we are working with outside counsel today on a companywide investigation of agent compliance. We do not want a single member of our armed forces to feel taken advantage of by our products or by the agents who sell them.

But I want to make clear that we believe our Horizon Life policy, which we market to both military and civilians, is a strong product. It offers benefits to our military policyholders, such as the ability to accumulate cash with no load whatsoever, not provided by the Servicemembers' Group Life Insurance subsidized by DOD.

I want to emphasize that we market Horizon Life as a supplement to, not a replacement for, SGLI.

Thank you, Mr. Chairman and members of the committee for your time and attention today. We at American Amicable pride ourselves on our integrity. We have already taken corrective action regarding the incidents at Fort Benning and Camp Pendleton. And we will take any additional action that is warranted by our continuing investigation.

We would be pleased to work with the committee to assist in the development of legislative measures to strengthen the financial education of our customers and to improve and better regulate the sales practices of companies who sell mutual funds, other investment vehicles, financial products and insurance policies on military installations.

I welcome your questions.

[The prepared statement of Joe W. Dunlap can be found on page 92 in the appendix.]

Chairman BAKER. I thank you both, gentlemen. You do come in to an environment where strong opinions are already established.

And in that light, I have just a brief set of slides I want to show you.

[The following information can be found on page 157 in the appendix.]

They are going to bring you, because it is on the wall behind you and I do not want you to have to turn around, they will present you with a hand copy. This is just a typical Horizon Life presentation sheet, just promotional in nature.

It is what the young man who was here earlier would have gotten, talking about the potential return for Horizon Life. And it is not really very descriptive of what the product is about.

Next slide. This gives sort of the rates of return. You focus more on that annuity accumulation thing, where the annuity and the life policy benefits kind of get cloudy.

If you read real close up at the top, then you can see that it is referencing a life policy. But the big things that catch the eye of someone is: "You give us your money." As a matter of fact, that is the line below the box that has the big word "opportunity" in it.

"You provide the time," meaning you stay alive. "You give us your money. And then we are going to take care of you."

And then those numbers in those blue boxes down there are very important. I will come back to that with some other additional data. I did not have time to get the chart prepared.

Go to the next slide. And this is just a typical demographic so the committee has an understanding: 24; $30,000; ranking three and up; typical service time, 7 years. That is important for everybody to remember.

Next slide. Now here is the thing that is perhaps the most striking. When you look at the Horizon Plan and your premium of $900 and the death benefit of $20,950, contrasted with the militarily available program of $240 annual premium for a $250,000 government benefit, this is where we begin to question the value of that life product.

And although it is supplemental to the military offering, why would most young people with few assets, few debts, headed to military service, concern themselves with coverage in excess of $250,000? I am not sure. But this helps to frame the problem in my mind as to the appropriateness of it.

Next slide. This looks at it over the 7-year term. Now the reason for the 7-year term, its significance, is this is the timeframe over which the average military term lasts.

So the typical retiree would have $4,945 paid in within the earned benefit of $20,950. You would have, in term premium paid into the government program, $1,680, with still the $250,000 coverage for that same period.

Next slide. And this is sort of an annuity, which most of those young men do not really understand very well. What is extraordinary about it is that in year 1 and 2, you note that you are actually in a negative return rate position, which as I understand, if someone were to choose to leave, there are significant consequences to that.

You do not get back to break even until just at year 2. And you track it on out all the way to the end and you are at about 3.75.

That is also significant because there is a guaranteed effective rate return of 4 percent.

But that is exclusive of sales and commission cost. So you are actually netting about 3.75, 3.8 percent, depending on the performance of the markets.

That is it. And the reason why I just wanted to get those facts into the debate, when we go to Fidelity's—this is the prospectus of a November 28, 2003, so I am using Fidelity's data—and we look at the annualized 5-year rate of return for Fidelity Destiny I, it had an annualized 5-year rate of return of—20.27 percent.

Now that was a rough period in the market. So we chose the S&P 500 index as a comparable, which is available through the thrift savings plans, which federal employees have and now military personnel have access to.

They would have earned a paltry 1.13 percent, had they been in the TSP. But that is still a 21.5 percent improvement over the Fidelity Destiny I product.

The facts are what trouble me here. It is that no matter how I come at this, who is it that designs the product and recommends that this be marketed?

I am not alleging you gentlemen are devising the product and intentionally going out and selling young people things that they do not need. From your testimony, it is clear you believe you are, in fact, providing a service that otherwise would not be made available.

But in the free market, if we had base commanders in the position to allow 20 companies on the base and had an insurance seminar and let people go around and pick what they wanted, I do not see how you survive in the comparison.

I will state it another way. If you had the choice to buy your life product at a monthly premium of $75, which is what it works out to be, with a guaranteed $20,950 life benefit, versus a military product at $20 a month for a $250,000 life benefit, which one would you buy?

Mr. DUNLAP. If I may, Mr. Chairman, can I explain or provide you comparisons?

Chairman BAKER. Please.

Mr. DUNLAP. Okay. As I said earlier, the Horizon Life product is absolutely not intended to replace Servicemembers' Group Life Insurance. In fact, we think that SGLI is a very good product. And certainly, we do not encourage any soldier to drop that coverage.

But to compare Horizon Life to Servicemembers' Group Life is very much an apples and oranges comparison. And if I may, I would like to give you just a few additional provisions about Horizon Life that hopefully will serve to distinguish it from SGLI.

Horizon Life is a combination of life insurance and an accumulation fund. It has two distinct components. But it always has these two components.

There is a seven-pay, 20-year term life insurance coverage in the product. By seven-pay, I mean that the premiums for the life insurance are fully paid up in 7 years.

Chairman BAKER. Isn't that because most servicemen leave the service in 7 years, so you make sure you get your premium?

Mr. DUNLAP. No, sir. We do not make that correlation.

Chairman BAKER. Then why would you pick a 7-year period to get a repayment? Why would you do that?

Mr. DUNLAP. I do not know.

Chairman BAKER. I was not alleging you were doing it. I am just saying, I am looking at it across the desk and saying, "Okay, why would I pay up 7 years for a product that has a 20-year life span?"

Virtually everything else you buy, the amortization schedule fits with the life of the product or close to it.

Mr. DUNLAP. Mr. Chairman, the product is sold as a long-term commitment. It is emphasized to the purchaser that it is a long-term commitment.

We have a building success program that we use in the majority of our field offices today. And it emphasizes just that. It does a needs-based analysis of the ability to pay.

And it also emphasizes the fact that this plan is a long-term commitment. That is the way that it works to the benefit of the customer.

Chairman BAKER. Now on your point about a needs-based ability to pay, are you suggesting that you sit down with an individual enlisted person, you get his financial condition and then you develop a product that fits his particular need? I thought this was pretty much a standard, boilerplate, $20,950 guaranteed death benefit. The annuity is on top of the life benefit.

Mr. DUNLAP. Part of the building success program does analyze the existing debts and payments that the applicant has.

Chairman BAKER. And what effect does that have on the premium or the benefit?

Mr. DUNLAP. I would assume in some cases that the agent would sell either a higher or lower premium, depending upon the facts that he determined through that analysis.

Chairman BAKER. So that you have a higher or lower benefit? I am not following. I thought we were looking at sort of a fixed package here.

Mr. DUNLAP. Certainly, you can pay a higher premium and have a higher death benefit or a lower premium with a lower death benefit.

If I may continue, Mr. Chairman, with a couple of other aspects of the product? As I was saying, the life insurance element is fully paid up after 7 years. At the end of the 20-year term period, all of the life insurance premiums are returned to the policyholder.

In year 2, the premium reduces by 25 percent. And in years 2 through 7, that premium is the amount payable. After 7 years, the life premiums are fully paid up.

I should add that not only does this product not have a war clause, none of the products that our companies offer today have a war clause; in other words, a clause that would prevent the payment of a death benefit in the event that death occurred in a war zone or due to hostile combat. In fact, this product, the Horizon Life product, has a benefit that, after the policy has been in force 1 year, the face amount is increased by 50 percent in the unfortunate event that death occurs in a combat zone.

And in fact, we have had a number of those cases in Iraq, unfortunately.

Chairman BAKER. I would hope that would be the case. My goodness, if you were selling a policy to an enlisted military personnel about to be deployed to an active theater and you would have an exclusion for war, there would be a reaction in this room that would be—let me put it this way, that did not help your defense. But please proceed.

Mr. EMANUEL. Yes.

Chairman BAKER. Mr. Emanuel says "yes."

Mr. DUNLAP. The other element is the accumulation fund. The accumulation fund does not have any loads. You deposit money into the accumulation fund, it goes into the accumulation fund. There are no loads.

There is a 5-percent withdrawal charge in the event that money is taken out during the first 10 years. After 10 years, there is no charge for withdrawals at all.

The current rate on the money in the accumulation fund is 6.5 percent. The guaranteed interest rate on the fund is 4 percent. And in fact, the historical average of the fund, I believe as I understand it, is approximately 10 percent.

Chairman BAKER. I am sorry, I did not mean to cut you off. Do you have further comment?

Mr. DUNLAP. I have gone to the FirstCommand.com Web page and looked at—well, this is called Cardinal Cornerstones. And in it, we discuss the availability of seminars. And in the explanation of the benefit, attending the seminar, it is described as "no get rich quick schemes."

That is the first thing that I found that is probably right on target. And I have reviewed all of the marketing information associated with the First Command product line.

I still do not have a good understanding as to how you feel that the rate of return for the individual involved in your product is being well served, given the information we have been provided. And I want to give you every opportunity to make us understand that our impressions of performance are not accurate. Can you help me?

Mr. SMITH. I would be pleased to, sir. Perhaps the best thing to do is to give you my personal example as a starting point.

I was a 29-year-old Air Force captain in 1976, back from Vietnam, newlywed. My wife and I were trying to get ahead. We had bought an annuity that did not seem to be promising too much.

We were saving a little money. We were not overspending.

But we were trying to get a bead on what the long term looked like. And I received an invitation in the mail to one of those seminars. And it was interesting to me. So my wife and I attended.

It was off the base. It was mostly my peers were in attendance. They were officers from the base in those days. And it was an informational and motivational seminar that gave me some ideas about how to structure a blueprint for success that would make sense.

I was then given an opportunity to have a personal financial plan developed. A representative came to our home in those days; we now work in offices.

He took a lot of information. He sat with my wife and I. We clarified our goals. We answered his questions.

He went away. And a plan of recommendations came back. It addressed insurance. It was very needs-based, which is a term I have heard here today that we subscribe to greatly.

The purpose of insurance is peace of mind and then actual benefit to survivors if death occurs. And I got a lot of peace of mind from knowing that my insurance was straightened out.

It contained savings recommendations. Savings are appropriate for near-term planned spending needs and emergency purpose. And the savings component of a plan is very important to protect the investment component, which fluctuates in value if it is equity-based, if you are investing in stocks or stock portfolios, which fluctuate in value. And it contained a recommendation for a Fidelity Destiny contractual mutual fund plan, 1976.

We bought it, $150 per month. That year, I made $22,700 as an Air Force captain on flying status. So $150 a month was not insignificant.

Today, that plan has been face changed increased. And I am investing $1,000 per month in that plan, that same plan. I have missed 4 months in all of those years.

And after that brief period of income interruption was completed, I made up that lost time. So essentially, I have not missed any lost time since 1976 in investing monthly.

I have invested $179,000 out of pocket, real money, my money, into that plan. I can liquidate it today for $531,000.

Chairman BAKER. Over what period of time? I am sorry.

Mr. SMITH. Since 1976 to about 3 days ago when these calculations were done.

Chairman BAKER. Have you ever taken that same set of figures and cranked it into, say, an S&P 500 rate of return or a no-load mutual fund return or any other program?

Mr. SMITH. Certainly it can be compared. And I have not specifically done that, but that is easily done.

Interestingly, my brokerage on that account is a hair under 3 percent at that point. And that is not the only contractual mutual fund account my family and I own.

We have six accounts. We have invested $438,000 out of pocket. And we have a bit over $1 million in there, including my only daughter's college money.

She is an entering freshman at Wake Forest. And her $120,000 for that experience is sitting in her contractual plan in her name, having invested for, guess what? 18 years.

Chairman BAKER. That has to be the trick, the fact that you were able to be in control of that fund for 18 years and not have her elect to make an early withdrawal. It is that point that is the key on which your plan works.

Mr. SMITH. Yes, sir.

Chairman BAKER. It is a rare set of individuals who are going to put money at risk and leave it in the market for 18 years. In this case, it was your infant child in whom you made this appropriate decision.

Almost investing in anything for your child over 18 years is better than no investment at all. My point is that the extraordinary front-end costs associated with participating in these plans has led

the private market to all but eliminate them from offering to traditional civilians.

If this is such a great product, why isn't it offered to the civilian marketplace?

Mr. SMITH. Thank you for the question, sir. Mr. Emanuel indicated that the contractual plan industry is about $15 billion. We have a hair over $9 billion invested from our clients. So it is being sold.

We understand from the plan sponsors, the big mutual fund companies that offer these, that there are 106 brokers who have sold these plans in the last 2 years. Now we do sell the majority of them. But it is sold in the civilian world.

Chairman BAKER. By majority, that would be like X percent?

Mr. SMITH. We understand that we represent about 70 percent of the sales.

Chairman BAKER. I thought it was closer to 90, but that is okay.

Mr. SMITH. I am giving you the information that I have from them.

Chairman BAKER. Sure.

Mr. SMITH. Also, there is some confusion, I think, based on earlier comments, about them being illegal in the civilian world. Not true. They are specifically authorized by the federal law.

And there is no different set of laws—federal laws—that pertain to military installations and military personnel. And your comment was that my infant daughter, who did not have any choice and I did it for her, had the discipline.

Part of the answer to your question is that this product is ideally suited to people who have steady income, relative insulation from financial catastrophe, who have the ability to understand commitment and planning and to make plans for their long term and commit.

Chairman BAKER. Mr. Emanuel?

Mr. EMANUEL. Mr. Chairman. You would agree though, Mr. Smith, nobody said they were illegal. They were discouraged over a long period of time.

Pretty much of the $15 billion that exists in contractual mutual funds, almost 90 percent, if not all, are in the military. Correct or incorrect?

Mr. SMITH. That is not my understanding, sir. And I am not here to speak for the entire industry. I am here to answer questions about our firm.

Mr. EMANUEL. That product has been discouraged by the SEC in the general public; is almost nonexistent as a product being sold in the general public; and of the $15 billion out of $7 trillion in the mutual fund industry, almost all of it is held by individuals in the military. And so you may not know that. But given that you sold 70 percent of it and your company sells it, I find it hard to believe that you do not know that information.

And if you have information to refute it, I would be interested. But right now, that is what is in the public knowledge, that basis.

Mr. SMITH. I can speak to the $9-plus billion that we have. And it is mostly military. It is almost all military.

Mr. EMANUEL. I appreciate that.

Mr. SMITH. And I am not here to refute.

Mr. EMANUEL. Okay.

Can I ask another question?

Chairman BAKER. Oh, please proceed. I have abused the time, so please go ahead.

Mr. EMANUEL. Mr. Smith, to follow up, what percentage of your product mix is contractual mutual funds? And I have a follow-up question on how you compensate your agents.

Mr. SMITH. Of the mutual fund operation, it is about 70 percent. Of the company at large, the revenues from contractual plans is about 20 percent.

Mr. EMANUEL. Okay. But in the mutual fund area, it represents 70 percent. And you represent about 70 or 80 percent of that market?

Mr. SMITH. We understand 70 percent.

Mr. EMANUEL. Okay. And almost all of it is held in the hands of people that are servicemen and women.

Mr. SMITH. Yes, in the leadership ranks.

Mr. EMANUEL. Okay. Second, in the compensation, in that area for your agents, do you have an open architecture? How are they rewarded in the selling of contractual mutual funds versus other products? Do they get a higher fee?

Mr. SMITH. The reason for the contractual plan——

Mr. EMANUEL. No, no. I asked you: how do you compensate your agents?

Mr. SMITH. We compensate them from the first-year commission, which is where the commission is, which mirrors the effort to create the sale, to create the service, to create the investor. That is the piece that is missing, Mr. Emanuel.

The big problem in this country is the savings rate. People are overspending. Credit card debt is going up; Personal bankruptcy. And those same features are represented in our all-voluntary military force.

The problem is not that they have the wrong investments; it is that they are not saving. It is that they are running up their debts and they do not have a plan for the future.

Our representatives spend time with these precious people and create a financial awakening. We help them get a spending plan on the table.

Oftentimes, we will help them cut up their credit cards. And we help them become savers and investors. That is immensely valuable.

Mr. EMANUEL. Mr. Smith, I do appreciate that. I agree with you that we need to have general savings in our society better than the consumption that goes on. But I asked you about the compensation of your agents.

But I will take that answer as is. Let me ask you this question: is there any scenario that you can have that you can describe, or any circumstance that you can describe, in which your product—the contractual mutual fund—is less expensive than a no-load savings?

Mr. SMITH. The no-load implies or the typical term "no-load" means that there is no brokerage. That does not mean that there are not fees.

Mr. EMANUEL. Okay.

Mr. SMITH. There is an expense to operate the fund. It is an expense ratio that is attached to——

Mr. EMANUEL. We have spent a lot of time here on 12b1-fees and associated costs, so we are okay.

Mr. SMITH. There are no-load funds with higher expense ratios, which when you do a hypothetical run out or an actual experience over a lot of years, where the total expenses charged against the portfolio actually exceed the expenses and the brokerage charged against the contractual plan. They do exist.

Mr. EMANUEL. I am done.

Chairman BAKER. Thank you, Mr. Emanuel. I am waiting——

Mr. EMANUEL. Thank you very much for being here.

Chairman BAKER. I am waiting on Mr. Burns to return. And in that brief moment—I will hold my questions until Mr. Burns is done.

Mr. Burns?

Mr. BURNS. I apologize for having to step out. I had some constituents here that needed just a moment of time.

I appreciate both of you being here. I know that sometimes criticisms have been public and heated and demanding. And I appreciate the fact that you are willing to come and you are willing to help and you are willing to work through this process and to find a solution that will be in the best interests of the clients that you have.

I have just a number of questions that I want to try and ensure. And I know that the chairman and Mr. Emanuel covered these. But there is always the question, as we look at insurance.

The young man who was with us in the first panel was from Fort Bragg and with the 82nd. Was he advised clearly about the SGLI availability, Mr. Dunlap? Do you know?

Was he informed? Did he have full disclosure? Was there transparency in this transaction?

Mr. DUNLAP. Congressman, no, I do not know that for sure. Obviously, there were some sales malpractices that occurred at Fort Benning. So I certainly do not know that for sure.

I do know there was a mention, in fact a documented SGLI coverage amount of $250,000 on the Army insurance solicitation form that came in with the application. But no, I do not know if he was advised of that. No, sir.

Mr. BURNS. Was it common practice for agents who may have marketed your products to present financial planning seminars in a group form? Was that typical or common practice?

Mr. DUNLAP. Congressman, we do not think so. We are very disappointed in what happened at Fort Benning. And we are trying to take remedial actions to guard against those things happening again.

Mr. BURNS. Were senior NCOs or junior officers compensated in any way to promote or provide access to an agent that might market your product? In other words, was there any form of remuneration or compensation to that drill sergeant who said, "This a good deal, you ought to sign up?"

Mr. DUNLAP. Congressman, I do not know. I have seen the investigative file at Fort Benning, which is heavily, heavily redacted. And I do not recall any reference to that in the investigative file.

Mr. BURNS. I think that is a tough question, but we have to—the reality of life is certain agents were given certain access. And they violated standing DOD regulations. And the question is: what motivated those individuals to do that?

And again, I want to thank you for accepting the challenge of dealing with the problem and recognizing it. Do you sell a term life policy that does not include an annuity?

Mr. DUNLAP. Yes, we do have one pure term life policy that does not include any accumulation element to it. Yes, Congressman.

Mr. BURNS. And again, I think part of the challenge we face is that as these products were marketed, they were not always clearly defined. In many cases—or, I should say, it appears that at least in some cases—individuals signed up for things they did not know what they were signing up for. And that is disturbing. So I think disclosure and the distinction between insurance and investments.

Now in your program, you refer to "the fund." Could you expand a little bit on the fund? You say you do not sell mutual funds, so this is not an instrument that you would take these dollars and purchase Fidelity or some other mutual fund investment, I assume.

What is the fund?

Mr. DUNLAP. Each Horizon Life policy has two components: the life insurance component and the accumulation fund component. The accumulation fund is a no-load fund. There are no charges, no deductions for deposits made to the fund.

The current interest rate on that fund is 6.5 percent.

Mr. BURNS. Right. And the minimum guaranteed is four. I heard the testimony. Now my question is: what do you do with the money? Where do you invest it?

Is this something that American Amicable invests? And is it not put into a particular mutual fund or a particular strategy, perhaps, as the chairman suggested, maybe an S&P 500 index or whatever?

Mr. DUNLAP. No, it is the funds accumulated for the benefit of the customer. But there are certainly no separate investment objectives for money in the accumulation fund.

Mr. BURNS. It just sits there?

Mr. DUNLAP. Well, obviously——

Mr. BURNS. It has to be managed. My point is it has to be managed.

Mr. DUNLAP. Obviously, the company has an investment portfolio, as all companies do.

Mr. BURNS. Right.

Mr. DUNLAP. And those funds are managed.

Mr. BURNS. But the purchaser of the product would not in any way have control over how those funds are invested. Those are pretty much the determination by your investment specialists?

Mr. DUNLAP. That is correct.

Mr. BURNS. Okay. As we look at contractual plans, I think I appreciate the input and the testimony. And I have tried to understand the challenges associated with those.

And again, we have talked about contractual plans being marketed in the military environment and not being marketed to the general public. Is there a specific reason for that?

Mr. SMITH. I believe so, Mr. Burns. The financial services industry—the brokers and the financial planners—have limited services

available and limited attention given to the beginning investor. And I think that what has happened with the contractual plan being less available in the civilian world is really a part of a bigger picture of the industry moving away from those who do not already have sums to invest accumulated.

The typical broker and financial planner today that is brokerage-based is looking for people who generally have $100,000 or more of investable income and can supplement that with on the order of $10,000 a year going forward. It is uneconomic, as a matter of fact, to spend the time necessary to do a lot of financial planning, of the type Ms. Jetton talked about.

She talked about a $100 per hour fee. Our representatives spend between nine and 17 hours with the clients and additional time on the case, working up the financial plans that we provide, which are comprehensive.

And that is an expensive process. And if the client is going to get the benefit, if the consumer is going to get the benefit, somebody has to pay for it. And generally, that has to be the consumer.

There are various models and ways for that to happen. Very few beginning investors, however, who are debt-ridden and stressed or they are just really getting started, even though they are in a position to get started financially, very few understand the benefit of the planning process and the advice given.

The contractual plan is a great way for us to reach our military customers. The reason they are still sold in the military is, I think, First Command. We are committed to this market.

They are generally beginning investors. And the contractual plan product is a model, which is legal, authorized in the federal law and which has worked well and which our clients appreciate and find benefit from.

Mr. BURNS. Mr. Bullard in his testimony, I had asked him the question about the statutory Investment Company Act versus the NASD limits. If we adopted—if we repeal the statutory regulations on contractual plans and set NASD or allowed NASD to set the limits on sales loads, how does that affect contractual plans?

How does that affect the marketing of contractual plans? And again, civilian versus military?

Mr. SMITH. That is for me, sir?

Mr. BURNS. Yes, sir. Please.

Mr. SMITH. I would believe that if Section 27 of the Investment Company Act of 1940, amended in 1970, is amended in the way that your bill calls for, that basically the contractual plan product would go away.

Mr. BURNS. What if it was an NASD as opposed to ban?

Mr. SMITH. It is difficult for me to predict how the regulators would view it. But it would be my estimation that the result would be about the same.

Mr. BURNS. Okay. Mr. Bullard also made a comment in his testimony—and you may not have had a full copy of it—but in his comment, he said that the level of compensation paid to brokers who sell the periodic payment plans—I am quoting him—″virtually assures that abusive sales practices will be more egregious and frequent than for other products.”

How do you respond? He suggests that because of the front load, that abusive sales practices would be more egregious and more frequent.

Mr. SMITH. Well, sir, at First Command, we enjoy the client relationships that I have already described in the leadership ranks of the military. These include 40 percent of the general officers on active duty today, in excess of about 30 percent of the commissioned and warrant officers and about 16 percent of the senior NCOs.

These are people with judgment. These are people with education. These are people who are used to decisionmaking and taking lots of data.

If they were being ill-served, they would speak up. And yet, if you review our complaint history, our consumer complaint history——

Mr. BURNS. It is very nominal.

Mr. SMITH. There is very little. The people who know us best—our clients—enjoy the relationship and feel that they benefit from it. And the numbers support that.

Mr. BURNS. Let's shift back to the insurance world for just a moment. In the agents' environments, these are independent agents that are marketing products that you would provide. Is that correct, Mr. Dunlap?

Mr. DUNLAP. Yes, they are independent.

Mr. BURNS. They are independent agents. One of the suggestions that has been made today is a registry of bad apples. And again, another suggestion was a disclaimer on some other products.

But let's talk about federal oversight and state oversight of insurance products marketed on our military bases. Your agents tend to be licensed within a state. Is that a fair statement?

Mr. DUNLAP. Yes.

Mr. BURNS. They are all licensed by a state either in securities or insurance or both. I think the clarification—I do not see any dissension as far as clarifying the position that insurance agents should be under the jurisdiction of the state that the military installation resides. I do not see any dissension there. Do we agree on that?

Mr. DUNLAP. Absolutely.

Mr. BURNS. My question then becomes: how do we deal with foreign installations? How do we deal with foreign installations where there is not an insurance commissioner on a foreign base? And I am asking for input.

Mr. DUNLAP. Well, that is a good question. And in fact, I think one comment that Governor Keating made earlier, which I thought was very good, is there needs to be increased coordination between the Department of Defense and the state insurance departments, in terms of identifying what these problems are and making sure that the information is communicated to the people that can take action on them.

Mr. BURNS. There have been several suggestions just in casual dialogue. But it could be the home-based installation.

For example, I have the 3rd Infantry Division, which is at Fort Stewart, Georgia. They were deployed to Iraq. They tend to receive multiple deployments over time.

If they were marketed a product, it could be at their home-based installation. Some of these are permanently assigned overseas.

They might be associated with a particular command. Or they may be associated with an individual's home community. Or they may be associated with the agent's home state.

So there are any number of options. And I am just saying we have to address that issue.

I think the problem that we face is we have to provide effective oversight and effective control and management in the sale of a product that is in the marketplace. And your agents, when they market your products off of a military installation, they certainly adhere to those regulations and those guidelines within a state, for example.

So if they are not in Fort Stewart and they are in Savannah, Georgia, then they are under the insurance commissioner in Georgia, who I think has done an excellent job of managing and monitoring that. We can clarify that. I think part of the challenge is: how do we deal with it from an international perspective?

Mr. SMITH. Mr. Burns?

Mr. BURNS. Yes?

Mr. SMITH. May I comment?

Mr. BURNS. Certainly.

Mr. SMITH. I would suggest that the DOD develop rules or strengthen their rules, that any agent that is going to market in aforeign area must have a stateside license in some state and that be on file with the installation. And he has to live by those rules, the rules of that state. And if there is a problem, then the insurance commissioner in that state has jurisdiction.

Further, Congress may consider in this connection encouraging the states, through the NAIC, through model regulations, for the states to adopt regulations in their states that require insurance agents who market to the military who are registered in their states to comply with the military regulations. And that gives an additional tooth to the state regulation if there are violations of military regulations.

Chairman BAKER. Mr. Burns, if I could get you to yield for a moment? Mr. Emanuel had another question before he has to leave.

Mr. BURNS. Certainly. Be happy to yield.

Mr. EMANUEL. Thank you, Mr. Burns. In 2000, if I am not mistaken, military men and women were allowed to get into the thrift saving plan that we have access to as members of Congress. And my gut tells me that their involvement—and it is a good enough plan for members of Congress and I think it is actually not just a good enough plan, I think it is an excellent plan—that plan has become a competitor to the contractual mutual fund.

And I believe that these should be banned and, if we cannot ban them, a clear warning be put on them. But now that we have another savings vehicle as a 401(k) plan, the type of thrift saving plan that we have that now the military can get in, that is that market opportunity and that choice that will steer them. And I would be interested: do you have any records of what has happened to your selling of your products since 2000?

Mr. SMITH. Our sales are stronger today than they were then. However, Mr. Emanuel, you said that the military has the TSP

that members of Congress and the other federal workers have. And that is not exactly true.

They do not enjoy one of the most significant benefits; and that is, matching funds. It is authorized within the law. But it has not been budgeted yet. And we hope that it will be.

And when it is, you are right. It is a hands-down favorite and should be the top recommendation. We believe that the comparison of the TSP to the other alternatives that are available—for instance, the Roth IRA—they are very sensitive to the assumptions that you make about taxation in retirement.

Mr. EMANUEL. I understand.

Mr. SMITH. If you plan to be successful, if you expect to be successful in a relatively higher tax bracket, the Roth IRA actually, we believe, offers some benefits worth considering. If you believe that you are not as likely to be in a high tax bracket at that time, then the military version of the TSP, even without the matching, is probably the superior product.

We work very hard to point this out to our clients and disclose this information and discuss it with them. And we did a sample of a recent 12,000 plans. And about 17 percent of those did have TSP recommendations.

Mr. EMANUEL. Thank you.

Mr. SMITH. Thank you, sir.

Chairman BAKER. Mr. Burns?

Mr. BURNS. Thank you, Mr. Chairman. Just a couple of points. Mr. Smith, are your employees, are they CFP or are they certified in financial planning or investing?

Mr. SMITH. Not a large number of them are. We have several. But that is not a requirement. However, we are moving in that direction.

Mr. BURNS. Finally, the New York Times mentioned a situation where an officer was in debt and still was encouraged by First Command to invest in contractual plans. Why would that be to his advantage? Why would that be a good recommendation?

Mr. SMITH. Thank you, sir, for that question. I am very pleased to talk about that. I have a four-page letter from that client, talking about the experience.

He is very pleased. I will summarize the letter briefly. He is very pleased with his financial progress that he has made since he became a First Command client and very pleased with our service.

He described his situation at the time that he first was referred to us as "a bit less than ideal." And I have his permission to give this information.

He had large credit card debt. He had missed some payments, not due to lack of financial ability to make them, but he was disorganized and he described himself as "less mature." His interest rate had kicked up in one case to 25 percent on one of those credit cards.

He had no car insurance. And you are required to have car insurance in that state. So he was very much at risk there.

He had set no goals and he had no savings habit. However, he had never been contacted by anybody else offering any help—no fee only planner, nobody else. He was promoted and received a pay

raise. And he thought that was a grand opportunity—correctly so—a grand opportunity for him to address his situation.

And so he asked around among his peers. And one of our clients, a satisfied client, referred him to us.

And he describes the situation, how our representative met with him a number of times to get to know him and to talk about the situation that he was in. He was impressed by the fact that it was not high pressure and it was focused on his best circumstance.

Our representative tried to get him a debt consolidation loan to pull down those debts, the effective interest rate. But he could not qualify because of his blemished credit history.

So the representative helped him understand the need to get on a regular habit with those payments. And he accelerated the financial payoff of the higher interest debt with a plan, which the lieutenant agreed with, that he would try again for a debt consolidation loan in about 6 months, with an expectation of a better credit history that he could qualify.

We put him in a balanced financial plan involving some life insurance, a savings—as we typically do to protect the investments—and starter investment plans. What we have found is that people who are in debt and who are needing to dig out, mathematically the case can be made without question that if someone has, for instance, 15 percent debt, any extra money that you can put against that 15 percent is like a guaranteed 15 percent return.

Mr. BURNS. It certainly is.

Mr. SMITH. However, if someone has dug himself into a hole and all he is going to do with every spare dollar is put it in the hole, put it in the hole, put it in and he does not see anything building up, our experience is that they typically become discouraged after a few months and they go back to the old habits. Or at least they are at risk of that.

So a small investment and some savings to see something building up above ground, so to speak, as well as emphasis on debt payoff, has been the winning formula. And this young man today describes himself as on-track, getting better fast. He has now qualified for that debt consolidation loan. And his effective interest rate is way down and his debts are being liquidated very rapidly.

Mr. BURNS. One of the biggest concerns that I have and especially among our younger adults is they are carrying an excessively high burden of high-interest debt. And I tell you, every dollar that reduces that debt is, to me, like you suggest, a very positive return.

Again, I want a balanced, effective solution. I want markets that work for our military. I do not wish our servicemen or women to be taken advantage of in any way. And I want them to be given quality advice and quality products.

If we have agents who are marketing either insurance products or investment products that need to be labeled as "dangerous to your financial health," then I think that is something that this Congress needs to pursue. I do appreciate the panel today and the input that they have provided because I think that helps us focus on what we need to do within the legislation.

And I am very grateful to the chairman and the ranking member for the opportunity to be a part of the hearing today. And I look forward to working with them as we pursue the legislation.

Thank you, Mr. Chairman.

Chairman BAKER. I thank the gentleman. I also want to extend my appreciation to you individually for appearing here. I think in fairness to you, I should say that you have not necessarily won me over to your position. But by getting your facts on the record, it may help you to a degree.

Mr. Dunlap, I would really recommend that you get to the committee some explanation of how the company executives do invest those annuity funds. It is not a mystical process. They are taking dollars from military personnel, putting them in a pool——

Mr. DUNLAP. Mr. Chairman?

Chairman BAKER. Yes?

Mr. DUNLAP. Just to make sure that I am clear on that and I gave the appropriate answer, any money that is accumulated for an individual policyholder is kept as a part of that policy.

Chairman BAKER. Sure. No, I understand that. And there is an accounting. But the money is fungible. And it is used in some investment strategy.

I am not saying the investment strategy is bad. I am not saying it is not working. I am saying we do not know what it is.

We do not know what fees or costs are associated with it. If they are taking those funds and putting them into equities and there is constant turnover in mutual fund holdings, that turnover generates fees for the sales and transaction costs. All of that has to be paid by that consumer.

And so the net rate of return from an annuity to the individual investor, to a great extent, is adversely impacted by managerial sales loads and undisclosed costs. It would be helpful for us to understand the performance of the fund by knowing more detail about what is going on, not within your purview, but within the investment side of the company for which you cannot speak today.

Further, you defend the life product performance and the costs associated with it because of that annuity portion of the product, which is the reason why I brought those annuity performance factors up for discussion. But even when you take the annuity performance, as reported by company documents, and look at the premium assessed for the package as it has been developed, the appropriateness of that product being sold to young individuals who do not have the financial sophistication—which both of you acknowledge they do not have—and that they are counseled to wind up at this conclusion is troubling.

Because if we look at options that would be available to them through the private market, through competitive opportunity, if we were to have the military go out and ask the top 20 companies to put together a package for military personnel across the country to provide an average $200,000 life benefit for some 10-and 20-year period, I guarantee you we could get a really good competitive product provided.

What seems to have happened here is that we have had a closed marketplace with military personnel—not in all cases, but in the reported press examples—using their stature among enlisted personnel to make them feel comfortable that this investment need no further examination. You have acknowledged that this marketing practice is not appropriate. We certainly agree on that point.

It is still very much a concern that once we get by those marketing practices and we look at the underlying consequence of the product being offered, not the manner in which it is offered, and the funds being collected, and the benefits potentially generated still do not square up in my book. But the committee is still open to further information, should the company choose to provide it.

Mr. Smith, without regard to your company or its practices, just with regard to contractual plans, they really are inconsistent with the financial goal of most Americans and certainly young military personnel. And I say that because the vast majority of financial planners who would have no vested interest in any particular direction will say with neutrality that only a few Americans who are fully invested in all retirement options, with idle cash looking for a place to get a rate of return, would likely look to a contractual plan as an advisable investment strategy.

As to your own company's practices, your goal of helping unsophisticated, troubled young folks with financial difficulties by taking half their initial year's investment out of the market is a problem from my perspective. If that were the goal, it would seem to either have a low annualized rate spread over the term of the product offering or at least a zero at the beginning, rising over time, as the assets develop in the individual's portfolio.

It is those early dollars in that get them out quicker. And by having the initial years' contributions, when it is most difficult for them to juggle paying off prior existing debts, perform their military duty and have half of their investment egg spent on company commissions is a problem.

I am not yet fully determined of the direction that the committee should take. And I regret that you gentlemen voluntarily appeared and that I have expressed opinions, which I know you do not appreciate. I thank you because I sense from each of you sincerity about your product and what you are doing.

We just have a disagreement about the value and the inconsequence of those products. Certainly, going forward, there are going to be definitive and decisive actions taken. And I would strongly recommend that senior officials from both companies urgently communicate any other information that might be advisable for this committee to know.

Chairman Oxley has indicated we need to do our due diligence. We need to make sure we understand. But we better get it done quick.

So with that, I thank you. And our meeting stands adjourned.

[Whereupon, at 2:20 p.m., the subcommittee was adjourned.]

A P P E N D I X

September 9, 2004

Opening Statement

Chairman Michael G. Oxley
Committee on Financial Services

Subcommittee on Capital Markets, Insurance and Government Sponsored Enterprises

"G.I. Finances: Protecting Those Who Protect Us"
September 9, 2004

Thank you, Chairman Baker, for convening this important and timely hearing. I also appreciate the bipartisan interest among the Members of this Subcommittee in protecting our GI's.

The men and women who protect our freedom by serving in the military are giving our country a precious gift. Through their dedicated service, this Nation is successfully fighting terrorism and promoting democracy abroad, keeping America safe and strong into the future. But as these young men and women risk their lives for our country, we have a responsibility to ensure their financial well-being and protection.

New military recruits brought in for basic training are often young and relatively inexperienced on financial matters. They are trained to obey commands without question and sometimes operate on little sleep.

It is unconscionable, if true, that groups of recruits have been marched into compulsory briefings on veterans benefits by salesmen pretending to be financial planners that quick-step them into signing up for what turns out to be long-term life insurance.

It is also unconscionable, if true, that firms are using retired military officers to make on-base sales pitches to groups of young recruits for mutual funds with 50 percent first-year commissions – a product that that has virtually disappeared from the civilian market. I have yet to hear any reason at all, let alone a good one, why these products are still being marketed to military personnel.

Perhaps most troubling, these reports are not isolated incidents from boiler-room operations. Some of the biggest names in the mutual fund business are sponsors of these contractual plans sold primarily to military personnel.

Problems with illegal sales practices by life insurance agents on military bases have been reported, studied, and debated by the Pentagon going back at least to 1974, and more recently in 1997, 1999, 2000, and 2003.

I do not support a complete ban of financial product sales on base, nor do I want to tarnish the good reputation of independent property- casualty agents or those life agents who are not involved in these sales. But Republicans and Democrats in Congress can no longer pretend this is about a few bad apples.

This is a systemic problem that needs to be fixed. I understand that NASD has been conducting a thorough investigation of contractual plans for more than a year and will have an announcement in the near future. The NASD is to be commended for its work to protect military investors.

I look forward today to a thorough analysis of the problem and potential solutions for Congress to act on this year.

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Opening Statement
U.S. Representative Judy Biggert (R-IL-13th)
Before the Financial Services
Subcommittee on Capital Markets, Insurance and
Government Sponsored Enterprises
Thursday, September 9, 2004

Thank you, Mr. Chairman, for holding this very important hearing today, for I believe it will send a clear message to our military personnel: we do care about your financial welfare. These men and women serve and sacrifice for America, and for the world, to ensure that all people dwell in freedom, liberty and justice.

One benefit of a free society is a free-market. A free market allows industries of all kinds the opportunity to compete, and consumers can benefit from a competitive marketplace that drives down the cost of products, including financial products. While consumers, including military personnel, can benefit from a free market environment, they are not immune to becoming victims of rogue organizations and bad actors who aim to line their own pockets by scamming consumers.

Today, we address recent reports of how some financial organizations have used abusive practices to sell financial products to military personnel. It is unacceptable if even one member of our armed forces is the victim of a rogue financial organization or a bad actor. It should not take a newspaper report or a congressional hearing to inspire a financial organization to stop illegal or unethical sales practices and policies that involve any person, let alone our military personnel.

As you may know, financial literacy is one of my top priorities, and it has been brought to my attention that financial organizations have voluntarily met with servicemen and women to educate them about financial services. While I encourage bona fide financial education programs that are conducted in a legal and ethical fashion, I am not an advocate for programs that violate Defense Department regulations or that are a sales pitch fronting as a financial education program. I am disturbed to read that young and impressionable members of our armed forces may be fooled into believing that they are being educated about finance but are in fact being influenced by salesmen who pose as instructors.

In our free society, we abide by the law and follow ethical and moral practices, particularly in business. However, our jury cannot and should not make a unanimous judgment about the situations that recently have been brought to our attention until we have heard the arguments of those who are involved. One is innocent until proven guilty. Following suit, I would encourage our witnesses today to fully disclose the accuracy of the report that "several financial services companies or their agents are using questionable tactics on military bases to sell insurance and investments that may not fit the needs of people in uniform."

Our military should know that we in Congress will not deny them access to the financial benefits of a free-market society, but we will take action, if necessary, to protect them from financial scam artists.

Statement of the Honorable Rahm Emanuel
Subcommittee on Capital Markets, Insurance and Government Sponsored Enterprises
September 9, 2004

- Mr. Chairman, thank you for holding this important hearing.

- The question we need to ask ourselves today is, if contractual mutual funds are such a great product, why aren't they sold to civilians anymore?

- And if they're not good enough for civilians, why are we allowing them to be sold to our men and women in uniform?

- There's no reason for contractual mutual funds to be sold to our military personnel. These funds were repudiated by the civilian market in the 1980s because the first-year commissions equal 50% -- HALF -- of the contributions.

- If they're not good enough to be sold to the general public, we shouldn't allow them to be sold to the military.

- Many of our troops are of modest financial means and need to cash in food stamps to feed their families. None of them can afford a 50% commission, nor do they probably realize they're paying that much.

- On the issue of life insurance sales on base, I'm more concerned about adequate disclosures, so it's crystal clear to our service men and women what they're buying.

- I think it's important that companies give recruits a 'Plain English' document telling them the U.S. Government doesn't endorse, recommend or encourage them to buy this life insurance. Clear disclosure and informed consent are the keys.

- **That is why I will soon introduce legislation to address these issues.**

- First, my bill would ban contractual mutual funds. Alternatively, it would require that we put a *'Surgeon General's'* warning on them, warning that they're harmful to your financial health – that there's a 50% commission, they aren't sold to civilians anymore, and the SEC recommended Congress ban them.

- For troops – who for family reasons feel they need to purchase more than $250,000 in life insurance -- my bill would allow them to buy up to $500,000 in insurance from the government at low cost.

- It also requires new disclosures, tightens guidelines for base access, and clarifies the role of state insurance regulators.

- If we want to allow access to military bases, fine…but our young men and women can't be seen as a ***fee machine*** for the financial services industry – and that's what contractual mutual funds have made them.

Thank you, Mr. Chairman.

September 9, 2004

Opening Statement by Congressman Paul E. Gillmor
House Financial Services Committee
Subcommittee on Capital Markets, Insurance and Government Sponsored Enterprises
Hearing entitled, "G.I. Finances: Protecting Those Who Protect Us"

Thank you, Mr. Chairman, for calling this hearing and for your important leadership on this issue. I am interested to learn more today regarding the recent allegations in media reports of questionable tactics and abusive sales practices utilized on military bases to sell insurance and investment products.

I share the concern of many of my colleagues regarding claims that Department of Defense (DoD) directives prohibiting the solicitation of recruits, trainees, and transient personnel in a "mass" or "captive" audience, using misleading advertising and sales literature, or giving the appearance that the DoD endorses any particular company are being violated.

I look forward to hearing from our industry witnesses this morning on their sales practices to military personnel and the particulars of their products specifically designed to meet the needs of our military servicemen and women. I also anticipate a full discussion regarding ways to improve the delivery of financial products to both active duty and reserve military personnel addressing their special circumstances and making sure they are adequately protected from fraudulent or abusive practices.

These men and women are fulfilling their duty to our nation by putting their lives at risk to protect our freedoms. It is clearly our duty to make sure they are being treated fairly.

Thank you again, Mr. Chairman, for calling this important hearing and I look forward to an informative discussion.

OPENING STATEMENT OF THE HONORABLE RUBÉN HINOJOSA
HOUSE FINANCIAL SERVICES COMMITTEE
SUBCOMMITTEE ON CAPITAL MARKETS
"G.I. FINANCES: PROTECTING THOSE WHO PROTECT US"
SEPTEMBER 9, 2004

Chairman Oxley and Ranking Member Frank,

Thank you for holding this very important and timely hearing today.

As we all learned this week, 1,000 U.S. men and women have lost their lives during Operation Iraqi Freedom, and each, including several from the Rio Grande Valley, should be remembered for their courage and valor in defending our nation and the principles for which it stands.

More than 70 percent of the dead are soldiers in the Army, and more than 20 percent are marines. More than half were in the lowest-paid enlisted ranks.

On average, the service members who died were about 26. The youngest was 18; the oldest, 59. About half were married, according to the death roll, which does not include a handful yet to be identified by the Defense Department and three civilians who worked for the military.

Part-time soldiers, the guardsmen and reservists who once expected to tend to floods and hurricanes, were called to Iraq on a scale not seen through five decades of war.

Increasingly, Iraq is becoming the conflict of the National Guard, and in growing numbers this spring and early summer, these part-time soldiers died there. Ten times as many of them died from April to July of this year as had in the war's first two months.

This past weekend, the Valley lost another of its soldiers while bravely serving his country during Operation Iraqi Freedom. On September 6, 2004, United States Army National Guardsman Tomás Garces died in Iraq. Garces died when his convoy was attacked by enemy forces using an improvised explosive device. Garces was assigned to the National Guard's 1836th Transportation Company from Fort Bliss, Texas. His family resides in Weslaco, Texas in my district.

At just 19 years of age, Tomás' loyalty to the cause of freedom was steadfast and clear. A 2003 graduate of Weslaco High School, Tomás was a champion wrestler, and took his lessons from the mat with him to the Guard.

In July, he had been recommended for a Bronze Star for his actions during an ambush.

These brave troops in our nation's military are working every day to guarantee the safety, security and freedom for Americans and Iraqis, and Tomás was no exception. My thoughts and prayers are with his parents, Rafael and Sonia, his brothers and sister, and his entire family at this difficult time.

Garces is the 10th soldier from the Valley to die in the line of duty in Iraq since the conflict began.

Over fifty percent of the U.S. military is comprised of minorities, including Hispanics, who sometimes have not completed high school and/or do not have the wherewithal to attend community colleges or universities. Consequently, they turn to the military for a better life.

These individuals tend not to be well-versed in financial services issues. Some of them do not even have bank accounts. Unfortunately, this is not very uncommon in the United States in general as financial literacy in this country is abysmal.

While I must condemn any company or industry that preys upon these brave individuals who risk their lives for our country and our Democracy, I realize that sometimes the negative actions and sales are done by a few bad apples and do not represent the industry as a whole. Life insurance and mutual funds, when appropriately crafted and appropriately marketed to our military, are just that....very appropriate.

But when someone goes after a financially unsophisticated, courageous youth headed into battle with a product that will not benefit his family if he does not return from his tour of duty alive, I have to draw the line.

Mr. Chairman, I hope today's hearing will shed light on the inappropriate sales of contractual mutual funds to our military personnel, and I would hope that all of you would pray for the family of National Guardsman Tomás Garces.

I yield back the balance of my time.

OPENING STATEMENT OF
RANKING DEMOCRATIC MEMBER PAUL E. KANJORSKI

SUBCOMMITTEE ON CAPITAL MARKETS, INSURANCE
AND GOVERNMENT SPONSORED ENTERPRISES

HEARING ON G.I. FINANCES:
PROTECTING THOSE WHO PROTECT US

THURSDAY, SEPTEMBER 9, 2004

Mr. Chairman, thank you for the opportunity to offer my initial thoughts about the marketing of certain securities and life insurance products to military personnel before we hear from our invited witnesses. I want to commend you for swiftly focusing our committee on this important issue.

In recent weeks, several stories in the *New York Times* have once again raised concerns about allegedly abusive practices in the sale of financial products to the men and women who serve in our Armed Forces. These accounts have detailed problems with financial literacy, potentially overly trustful troops, and business products and practices that have raised the concerns of many.

For example, many financial advisors point out that rather than committing to long-term contractual plans with large front-load fees, most investors would be better off setting up automatic savings programs with smaller fees and initial sales loads. Additionally, while many in the military may have greater life insurance needs than average Americans, we need to ensure that the products they purchase meet their needs and best serve their long-term purposes.

Without question, we need to work in Washington to protect those who protect us. As a result of today's proceedings, I hope that we will gain a better understanding of the military financial services marketplace. We already know that our soldiers are more mobile than average Americans. The recent news reports have also highlighted potential limitations faced by financial regulators on military bases, particularly on those installations located abroad. Both of these issues deserve further exploration today.

In recent days, we have also begun consideration of legislation that would ban the sale of mutual fund contractual plans. This bill also seeks to improve the regulation of life insurance and other financial products sold on military bases. In order to prevent unintended consequences, I must urge my colleagues to move deliberately and diligently in these matters.

As at least one witness points out in his prepared testimony, efforts to eliminate contractual agreements might have an effect on variable annuity market. It could also result in problems for those who have already purchased these plans. Before we move ahead in these matters, I would therefore urge you, Mr. Chairman, to consult with the Securities and Exchange Commission, the National Association of Securities Dealers, the National Association of Insurance Commissioners, the Department of Defense and other interested regulatory entities to ensure that any bill we craft appropriately fixes these problems before we adopt them into law.

In closing, Mr. Chairman, we need to improve financial education for military personnel. We need to improve the enforcement of consumer protections for not only the men and women

in our Armed Forces, but also for all Americans. We additionally need to have better supervision in the sales of financial products on military bases. I want you to know that I am committed to addressing these matters. These are important discussions for us to have and important matters for us to resolve.

Statement of Congresswoman Sue Kelly
"Protecting our Financial Infrastructure: Preparation and Vigilance"
September 9, 2004

This morning, the Committee convenes to continue its ongoing oversight of preparedness, incident-recovery and critical infrastructure protection issues. I thank Chairman Oxley for holding this hearing.

At the heart of critical infrastructure is the safety and soundness of the financial services sector, which drives every aspect of our economy. Earlier this Congress, the Oversight and Investigations Subcommittee held a hearing to examine the state of readiness of the financial services sector and the critical infrastructure that allows it to serve our country. In that hearing, the Subcommittee learned about the many promising steps that have been taken by our financial caretakers, as well as the constant assessments and improvements that still must be performed.

Over the last several years, our country has experienced many extraordinary events that have threatened the safety of the American people and our financial system – from the horrific attacks of September 11, 2001 to other blackouts and hurricanes. Fortunately, our markets have experienced remarkably quick recoveries, illustrating the tremendous resiliency of our financial system and the U.S. economy.

As a result of these events, it is apparent that the technology age we live in – which allows us to provide services and access information in a heartbeat – is both a boon and one of our greatest vulnerabilities. It is imperative that we continually revise our efforts to protect data systems and the infrastructure that allow them to operate, which are evermore intertwined and dependent on one another. Today, this review could not be anymore timely.

Last month, Department of Homeland Security Secretary Tom Ridge issued a warning of possible al-Qaeda terrorist attacks to our financial institutions, including Prudential Financial, the Citigroup Center building and the New York Stock Exchange, as well as the International Monetary Fund and World Bank buildings. The Committee is very interested in the steps that have been taken to protect our financial infrastructure since the threat level was elevated to Code Orange for the financial services sector in New York City, northern New Jersey, and Washington, D.C.

As terrorists continue to target our economy and financial institutions, we must ensure our financial infrastructure is strong enough to withstand diverse attacks. We must ensure that all of our systems – whether financial, energy, transportation or telecommunications – are able to operate under any extraordinary circumstances.

The Committee is pleased to have with us Federal Reserve Board Governor Mark Olson who has been a leader in these efforts in his role at the Fed. We also welcome the Assistant Secretary for Financial Institutions at the Treasury Department, Wayne Abernathy, who also serves as the Department's sector coordinator for critical infrastructure protection. Also joining us is the Assistant Secretary of Homeland Security for Infrastructure Protection, Robert Liscouski, who is responsible for the Department's efforts to identify our critical infrastructures and propose protective measures to keep them safe from terrorist attacks.

Keeping our financial systems functioning and safe requires a high degree of coordination between many different and important parties – both public and private. The Committee is also pleased to have with us witnesses on our second panel who are leaders in protecting critical financial services assets from major disasters – including several individuals from the Great State of New York. These witnesses, along with others in the private sector and government who could not be represented here today, are working in the field every day to protect our financial system.

The Committee thanks all of our witnesses for your appearance here today, and we look forward to your testimony. Together we can ensure that our financial systems are functioning smoothly under all circumstances and that the American people have full confidence in the financial services sector.

Statement for the Record
Congressman Bob Ney

"G.I. Finances: Protecting Those Who Protect Us" Hearing
Subcommittee on Capital Markets, Insurance, and Government Sponsored Enterprises
September 9, 2004

Thank you, Mr. Chairman, for holding this hearing today. As a member of the Financial Services Committee and this subcommittee, I am interested in addressing any and all allegedly abusive practices in the financial services industry.

In addition, as a member of this committee who has been actively involved in the predatory lending debate, I am particularly interested in dealing with the allegedly abusive practices that we will address today. Although these practices do not involve predatory lending as we have come to understand that issue, some of the practices involving the sale of financial products that we will address in this hearing are certainly abusive and predatory in nature.

Worse still, these abusive and predatory sales practices are being perpetrated upon the men and women of our armed forces – the same men and women that we rely upon to protect us and who honorably serve this country. The New York Times article that preceded this hearing profiled a 19 year-old specialist whose mother is from Ohio. This young soldier was paying $100 per month in premiums for a life insurance policy with a benefit of less than $44,000. When compared to the $250,000 of life insurance he already had through a military-sponsored plan costing him only $16.25 per month, it becomes clear that this young soldier, who had just graduated high school, was being taken advantage of.

It is incumbent upon all of those involved, not just Congress, to see that these abusive and predatory sales tactics are not practiced on our military personnel. Ultimately, I believe that the abusive practices that will be discussed today are not an industry-wide problem. However, those in the industry who are best positioned to correct these abuses must take action.

I do not believe the solution lies in another layer of regulation on top of the ones that are currently under-enforced, or in banning financial services companies from military bases entirely, or in suitability regulation. Instead, I hope that Congress' role will be to help those involved to use the tools already available to them to combat this problem. Indeed, many safeguards and procedures currently exist to prevent these abusive practices – from regulatory action at the state level against those licensed to sell these financial products to internal regulations by the companies that employ the selling agents to enforcement of Defense Department regulations regarding the sale of financial products on military installations.

I commend those of the witnesses here today who are trying to be part of the solution rather than part of the problem. Thank you all for coming today. I look forward to hearing your testimony.

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Testimony of Mercer E. Bullard

President and Founder
Fund Democracy, Inc.

and

Assistant Professor of Law
University of Mississippi School of Law

before the

Subcommittee on Capital Markets, Insurance
and Government Sponsored Enterprises

Committee on Financial Services

United States House of Representatives

on

G.I. Finances: Protecting Those Who Protect Us

September 9, 2004

Executive Summary

Reports of sales of overpriced, unsuitable investments to U.S. military personnel are unfortunate – and entirely predictable. Current law permits sales loads on sales of periodic payment plans that substantially exceed limits on similarly structured mutual fund products. These excessive sales loads encourage brokers to engage in aggressive sales practices and to sell inappropriate investments. There is no reasonable basis for exempting periodic payment plans from the rules that apply to similar products. Congress should amend the Investment Company Act to authorize the NASD to regulate sales loads on period payment plans.

Chairman Baker, Ranking Member Kanjorski, members of the Subcommittee, thank you for the opportunity to appear before you to discuss the sale of unsuitable and overpriced financial products to U.S. military personnel. It is an honor and a privilege to appear before the Subcommittee again today.

I am the Founder and President of Fund Democracy, a nonprofit advocacy group for mutual fund shareholders, and an Assistant Professor of Law at the University of Mississippi School of Law. I founded Fund Democracy in January 2000 to provide a voice and information source for mutual fund shareholders on operational and regulatory issues that affect their fund investments. Fund Democracy has attempted to achieve this objective in a number of ways, including filing petitions for hearings, submitting comment letters on rulemaking proposals, testifying on legislation, publishing articles, lobbying the financial press, and creating and maintaining an Internet web site.

I. INTRODUCTION

Recent reports of abusive sales practices on military bases describe a problem that is, unfortunately, not new in the financial services industry. While it is particularly offensive that insurance agents peddle overpriced, unsuitable products to the men and women who daily put their lives on the line for America's defense, it should be recognized that their experiences are not unique. As described in section II of this testimony, the historical parallels to practices that were commonplace in the 1930s are striking.

Congress should promptly take steps to prohibit the charging of excessive sales loads on periodic payment plans. Mutual fund sales loads have long been subject to limits imposed by the National Association of Securities Dealers ("NASD"), whereas sales loads charged on periodic payment plans have been subject to more liberal standards set forth in the Investment Company act of 1940 ("Act"), as explained in

section III of this testimony.[1] As discussed in section IV, periodic payment plans should be subject to the same standards as mutual funds.

There are certain other issues that, while not addressed in detail in this testimony, are illustrated by the reports of sales abuses on military bases and should be considered by the Subcommittee.

First, the Subcommittee should consider the regulation of investment advice on a broad scale. The excessive sales loads mentioned above are unique to periodic payment plans, but the investment advisory problems are not. The inadequate regulation of financial advice provided to military personnel is characteristic of inadequate regulation of advisory services throughout the securities and insurance industry. Brokers who provide individualized investment advice often are not regulated as investment advisers or subject to fiduciary standards, and insurance agents often are not subject even to minimal suitability standards. Both categories of professionals are providing individualized investment advice and accordingly should be held to a fiduciary standard of care.

Second, the Subcommittee should consider how to address the special vulnerability of military personnel, especially junior personnel, to abusive sales practices, whether such practices involve periodic payment plans, life insurance, home financing or any other retail product. The isolated, command nature of military life is a double-edge sword. It creates unique opportunities for the government to protect our soldiers from abusive sales practices, and for salespeople to more easily exploit unsophisticated investors. Sales practices on military bases should be regulated by a centralized office in the military, which should work closely with state securities regulators and the Securities and Exchange Commission ("SEC" or "Commission").

[1] The underlying investments in which periodic payment plans invest are typically mutual funds. For purposes of simplicity, the term "mutual fund" as used in this testimony refers to mutual funds sold outside of periodic payment plans.

Finally, the financial services industry is regulated under a dysfunctional, smorgasbord of rules promulgated and enforced by a wide variety of state and federal regulators. The reports on sales abuses on military bases illustrate how this patchwork of financial services regulation compromises consumer protection, increases costs, and suppresses competition. Congress should begin a systemic review of financial services regulation with the goal of efficient, functional regulation of all financial services providers and products.

II. BACKGROUND

In the 1930s, the Commission identified problems with the sale of periodic payment plans[2] that echo the problems identified in a recent series of reports. These plans were designed specifically to appeal to financially unsophisticated investors who could afford only small, periodic investments. Investors paid sales charges twice: once on their investments in the plans and again on subsequent purchases of securities in which the plans invested. These sales charges in some cases exceeded 20% of the amount invested. The effect of the excessive loads was exacerbated by the fact that they were usually "deducted entirely from the payments made in the early months of the installment plan."[3]

As discussed further below, Congress has twice attempted to address this problem of excessive loads, but recent reports of sales abuses on military bases indicate that the problem persists. The reports document instances in which only half of an investor's initial payments into the plans are actually invested, with the agent pocketing the other half. The reports describe the intensive, personal sales practices used by brokers on

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[2] See generally Louis Loss and Joel Seligman, Securities Regulation at §§ 1-H-6(c)(i)(2) & 2-F-2(c) (2004); Tamar Frankel and Ann Taylor Schwing, "Periodic Payment Plans," 4 The Regulation of Money Managers at § 27.01(B)(6) & ch. 28 (2004); Protecting Investors: A Half Century of Investment Company Regulation, Division of Investment Management, U.S. Securities and Exchange Commission at 382 – 84 (May 1992); Public Utility Holding Company Act of 1935, Release No. 1734 (Sep. 27, 1939) (discussing report on periodic payment plans dated March 31, 1939).

[3] Release No. 1734, supra.

military bases that are encouraged by the excessive loads they receive. The unsuitability of the securities and insurance products that are purchased reflects the similarly inappropriate investments made many years ago. Even the practice of specifically seeking to exploit military personnel is a familiar one.[4]

There is also a historical parallel for complaints by firms that they could not afford to operate if they were not permitted to charge excessive sales loads and accelerate the deduction of loads. When Congress first limited sales loads on periodic payment plans, plan distributors persuaded the Commission to grant a temporary exemption from new limits.[5] The Commission rejected a number of individual requests for exemptive relief, such as one by a company that argued that the new sales load limits would put them out of business.[6] Recent reports of sales abuses illustrate that some distributors of periodic payment plans have survived and are thriving – at the expense of America's investors.

III. REGULATION OF SALES LOADS ON PERIODIC PAYMENT PLANS

Federal law generally does not substantively regulate prices in the securities markets, choosing instead to rely on full disclosure and competition to regulate prices. One exception to this principle is the regulation of loads charged on sales of mutual funds, and particularly on shares sold pursuant to periodic payment plans, which have been subject to substantive limits since the federal securities laws were adopted.

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[4] See, e.g., In the Matter of Civil and Military Investors Mutual Fund, Inc., Investment Company Act Rel. No. 2723 (finding that name of periodic payment plan was misleading because it implied that the fund would provide special investment and other advantages, which did not exist, to government personnel).

[5] See, e.g., Investment Company Act Rel. No. 96 (Mar. 21, 1941) (amending rule N-6C-1 to exempt periodic payment plans from certain limits on sales loads), No. 28 (Dec. 10, 1940) (extending exemption for periodic payment plans from December 31, 1940 to February 15, 1941) & No. 3 (Oct. 25, 1940) (adopting rule N-6C-1 exempting periodic payment plans from, among other things, new restrictions on sales loads in the Investment Company Act until December 31, 1940). The Investment Company Act of 1940 became effective on November 1, 1940. See also In the Matter of Insurance Industries, Inc., Investment Company Act Rel. No. 75 (Mar. 1, 1941) (ordering hearing on request to permit 10% load on periodic payment plan).

[6] See In the Matter of American Participations, Inc., Investment Company Act Rel. No. 249 (Nov. 5, 1941) (denying request for exemption to permit sales load charges in excess of statutory limits).

Since its inception, the Investment Company Act has limited to 9% the total sales load that can be charged on sales of period payment plans. That limit applies to the sum of all of the payments made during the life of the plan. This is the only express limitation in the federal securities laws on the amount of brokers' commissions.

The Act also restricts the way in which a periodic payment plan sales load is collected. Section 27(a) prohibits: the deduction of more than 50% of the aggregate sales load from the first 12 monthly payments, the subsequent deduction of any sales load that is proportionally larger than any of the initial 12 deductions, and any subsequent deduction that is proportionally larger than any other subsequent deduction.[7] Thus, the Act permits half of the total payments to be counted toward the sales load until the entire 9% sales load has been paid.

During the 1960s, the Commission reviewed the distribution of periodic payment plans and, finding that many of the abuses that occurred in the 1930s were still prevalent, recommended that sales loads be limited to 5% for all sales of investment company shares. Congress decided to leave the 9% limit on periodic payment plan sales loads intact, but amended Section 27 of the Act to provide additional protection to purchasers of the plans. In 1970, Congress required that purchasers who cancelled the plan within 18 months receive the value of the account plus any sales loads in excess of 15% of the gross payments made. Congress also required that purchasers be provided with a notice of their 18-month cancellation rights and their right to cancel the plan within 45 days of receipt of the notice and receive the value of the account plus all sales loads ("cancellation notice"). Alternatively, a plan was not required to provide the 18-month withdrawal option if it deducted no more than 20% of any single payment, and on average no more than 16% of the first 48 monthly payments.

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[7] The original version of Section 27 actually required that remaining sales load deductions after the first year be spread proportionately across the life of the plan, see Loss § 2-F-2(c), supra note 2, but this requirement was weakened when Congress amended Section 27 in 1970, as discussed below.

In the same legislation that added these provisions, Congress specifically authorized the NASD to adopt rules prohibiting brokers from charging "excessive sales loads" on the sale of investment company shares. The NASD subsequently imposed limits on such sales, but these did not apply to periodic payment plans.[8]

NASD Rule 2830 provides that any sales charge in excess of limits enumerated in the Rule shall be deemed excessive. The maximum sales charge under the Rule is 8.5%, which must be reduced depending on whether dividends are reinvested without incurring an additional charge, minimum discounts are available for large purchases, and/or asset-based distribution fees are imposed. In practice, sales loads rarely exceed 5.75% and are often substantially lower.

The difference between the statutory and NASD limits on sales loads is dramatic. To illustrate, if a purchaser bought a periodic payment plan that provided for payments of $100 per month for 10 years, the total sales load would equal $1,080, and that entire amount could be deducted during the first 22 months of the plan. If the purchaser cancelled the plan within the 45-day cancellation period, he would receive the value of the account plus all sales load payments. If he canceled within 18 months of the purchase, he would receive the value of the plan plus $630 and would have paid an effective sales load of 15% ($270) on the aborted investment.[9] If he canceled after 19 to 21 months, he would not be entitled to a refund of any of the sales load, which would result in an effective load of 50%.[10]

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[8] The NASD presumably did not apply its rules to sales loads paid on periodic payment plans out of deference to the specific limits on such sales loads in the Act, which limits had been amended at the same time that Congress granted the additional authority to the NASD.

[9] The purchaser would have paid $900 in sales charges (.5 * $100 * 18 = $900). The distributor would be entitled to keep 15% of the gross payments of $1,800, or $270. See generally Diana B. Henriques, Basic Training Doesn't Guard Against Insurance Pitch to G.I.'s, New York Times (July 20, 2004) (one of every four First Command plans is cancelled before completion).

[10] For example, after 19 months the purchaser would have paid $950 in sales charges (.5 * $100 *19 = $950) out of gross payments of $1,900.

In contrast, NASD rules provide that a purchaser of shares of a mutual fund would never pay more than an 8.5% sales load, and in most cases would pay substantially less, even if the investor sold the investment after a short period. The following table illustrates the difference in permissible sales charges, using a 5.75% front-end sales load, which is typically the highest load charged in the mutual fund industry.

Table A: Comparative Sales Loads

	Periodic Payment Plan		Mutual Fund
	Option A: 50% Maximum	Option B: 20% Maximum	
Cancellation within 45 days of receipt of cancellation notice	0%	0%	5.75%*
Cancellation within 18 months	15%	16%	5.75%*
Cancellation after 19 to 21 months	50%	16%	5.75%*
Cancellation after 22 or more months	9% - 50%	9% - 16%	5.75%*

* Load funds often offer a share class that imposes a deferred sales charge that declines the longer the shares are held, as well as a share class that imposes a substantially lower asset-based sales charge. For example, an investor that sold his shares after one year might pay a deferred sales charge of 4.75% or asset-based sales charges of 1.00%.

Thus, periodic payment plans and mutual funds are subject to very different restrictions on sales loads. Brokers who sell interests in periodic payment plans are permitted to charge substantially higher loads than those who sell mutual funds, and loads on periodic payment plans can be collected on an accelerated basis. As discussed in the next section of this testimony, there is no reasonable basis for such differential treatment.

IV. ANALYSIS AND RECOMMENDATIONS

Some have argued that a high-level, accelerated commission structure is necessary to pay for the cost of selling periodic payment plans. The theory underlying this "cost" argument is presumably that it is more expensive to service the kind of investor to whom periodic payment plans are sold. Periodic payment plans are typically

sold to investors with limited means who cannot afford to make large, lump-sum investments. The smaller contribution amounts therefore generate lower commissions to cover the sales costs. If payment of sales loads could not be accelerated, full recovery of distribution costs would take years, thereby reducing the incentive to sell the product. In addition, investors with limited means also may be more likely to cancel a plan, thereby leaving the distributor with an even smaller commission if accelerated deductions are not allowed.

This rationale may have made sense years ago, but it is directly contradicted by current mutual fund sales practices. Load mutual funds routinely provide for systematic investment plans where the investor invests a small amount every month and is assessed an NASD-regulated load only on that amount, thereby suggesting that brokers find these sales to be sufficiently remunerative. In many cases, the sales load charged is well below the NASD's legal limit. These plans typically permit the investor to aggregate the total payments in order to qualify for commission discounts for larger purchases, which further reduces the sales load. Thus, for years load mutual funds have offered systematic payment plans subject to NASD limits on sales loads, thereby refuting the argument that applying these limits to periodic payment plans would not be profitable.

Some mutual funds have investment minimums that are $500 or less, which means that the broker selling the fund shares may receive only about $25 on the purchase, with no guarantee of any additional commissions on follow-on sales. If that one-time $500 investment had represented five $100/month payments in a periodic payment plan that was canceled after five months, **the broker's commission would be 300% higher**. Similarly, if a mutual fund broker can survive on a $100 commission on a $2,000 investment, why does a broker need a $1,000 commission when the same $2,000 investment is made through a $100/month periodic payment plan that is canceled after 20 months? In each case, the shareholder invests the same amount over the same period, **but the commission paid to the broker for the periodic payment plan is 1,000% higher**. The Commission's description of periodic payment plans sold in the 1930s

continues to apply today: "[i]n the early stages of plan participation, an investor receives little more than the opportunity to pay excessive sales loads on initial payments."[11]

Many mutual funds collect sales loads through low-level asset-based fees, known as 12b-1 fees. For example, a purchaser of a mutual fund's Class B shares (usually considered the most expensive, least suitable class for a typical investor) might pay only 1% annually in 12b-1 fees, which would not cover actual distribution costs for a number of years. The distributor is able to pay the broker an upfront commission, however, by borrowing the payment from a bank or other lender and using the expected income stream from the 12b-1 fees as collateral.[12]

The difference between the amount of commissions paid when a mutual fund charges a 12b-1 fees and when a periodic payment plan is used is dramatic. For example, if the investor bought $100 worth of mutual fund shares every month for two years, he would pay about $25 in distribution fees assuming a 1.00% asset-based fee (or $120 assuming a 5% front-end load). If the same investor had invested through a periodic payment plan, he would have paid $1,080, **or approximately 4,320% more in commissions.** The introduction of 12b-1 fees, rather than impeding the sale of mutual funds, is partly responsible for the enormous growth of the mutual fund industry over the last two decades.

Thus, neither the 9% sales load limit nor the ability to accelerate the payment of the sales load can be justified in light of current sales practices in the mutual fund industry. Mutual fund brokers frequently sell to investors who are similar to investors in periodic payment plans, yet they charge sales loads that are often a small fraction of the sales loads that Congress permits for periodic payment plans.

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[11] Protecting Investors, supra note 2 at 390 – 91.

[12] See generally Rochelle Kauffman Plesset and Diane E. Ambler, The Financing of Mutual Fund "B Share" Arrangements, 52 Bus. Law. 1385 (August 1997).

If the higher, accelerated sales loads are not needed to sell periodic payment plans, then what is the explanation for such loads? The logical explanation is that the extra compensation is funding precisely the kind of aggressive sales tactics that prompted Congress to substantively limit sales loads on periodic payment plans over 60 years ago. As the Commission has noted, the problem of excessive loads was "inextricably related to the [intensive] method of distributing certificates."[13] The more a salesperson is paid for selling a product, the more money and effort the broker will expend on sales activities, and the more shares the individual broker will sell. The amount of the permitted sales load drives the sales expenditures, not the other way around.

This explanation is consistent with the evolution of load mutual funds and periodic payment plans. Where sales loads are subject to NASD limits, mutual fund assets, including assets invested pursuant to systematic investment plans, have grown enormously over the last 25 years. Competition has consistently reduced distribution costs such that the highest sales loads are typically well under NASD limits. In contrast, overpriced periodic payment plans have a relatively small asset base. Sales of periodic payment plans is quite remunerative for the niche players who sell them, but their cost structure limits their growth potential.

The relative success of sales of periodic payment plans to military personnel is virtually assured by their sales structure. The sales structure encourages brokers to engage in precisely the kind of personalized, affinity sales practices described in the reports on periodic payment plans sales abuses. The intensive use of "education" seminars and social gatherings, the exploitation of the implied authority of brokers who are retired military personnel, and limited access to the military market all combine to create an artificial, niche market where the sale of high-priced, aggressively marketed products will thrive.[14]

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[13] Release No. 1734, supra note 2.

[14] See Basic Training, supra note 9.

This market also insulates brokers from regulatory scrutiny, as the military is not well-suited for regulating financial services, as this is not its primary mission. Yet the military actively exercises authority over on-base sales practices, which gives the impression that it approves of financial products that are sold on-base.[15] Military regulation also creates uncertainty as to who is the appropriate rulemaking and enforcement body and naturally deters state and federal regulators from intervening. The mobility of military personnel and the location of many bases abroad further exacerbate the regulatory vacuum.

While improvements in the oversight of on-base sales practices would reduce the degree and frequency of abusive sales practices, the level of compensation paid to brokers who sell periodic payment plans virtually assures that abusive sales practices will be more egregious and frequent than for other products. Current limits on sales loads on periodic payment plans provide brokers with a powerful economic incentive to engage in aggressive sales practices and to sell unsuitable investments. When regulators are not looking, these pressures will inevitably result in the continuation of abusive sales practices and the exploitation of military personnel.

As recent reports on sales abuses on military bases indicate, these abuses have been a persistent problem for years,[16] and a structural solution is necessary. Congress should authorize the Commission and the NASD to adopt rules regulating the sale of periodic payment plans, and repeal existing limits on sales loads charged on sales of periodic payment plans as of the adoption of such rules. Such legislation should state expressly that restrictions on sales loads for periodic payment plans and similar products should be the same unless the basis for any difference has been fully documented and

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[15] As one member of this Subcommittee was quoted saying: "'When the Pentagon lets these things be sold on base, it's implicitly saying these products are O.K., and they're not O.K.'" Diana Henriques, Sales of Investments to G.I.'s Under Scrutiny in Washington, N.Y. Times (July 22, 2004) (quoting Representative Rahm Emanuel). See also Basic Training, supra note 9 ("'When we allow a person on an installation,' Mr. Molino[, deputy under secretary of defense for military community and family policy,] said, 'there is at least the implication that we have sanctioned your presence.'")

[16] See Basic Training, supra note 9 (citing reports prepared in 1997, 1999, and 2000, and abuses described in article in The Army Times in 1974).

reported to this Subcommittee.[17] Such reforms are necessary to help our soldiers benefit from the free market system they are fighting to defend.

[17] Accord Protecting Investors, supra note 2 at 405 – 406 (recommending that Congress adopt a reasonableness standard for insurance products that would "approximate the standard for regulation of mutual fund sales charges" as imposed by the NASD).

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Testimony of
JOE W. DUNLAP

EXECUTIVE VICE PRESIDENT, OPERATIONS

American Amicable Life Insurance Company of Texas

Before the United States House of Representatives

Subcommittee on Capital Markets, Insurance and

Government Sponsored Enterprises

of the

Committee on Financial Services

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INTRODUCTION

Chairman Baker, Ranking Member Congressman Kanjorski and members of the Subcommittee, my name is Joe Dunlap. I am here on behalf of the American Amicable Group. I have worked at American Amicable for 26 years and have served as Executive Vice President, Operations for the past year and a half. I served as Vice President, Policy Administration for 18 years before that. My resume is attached.

Thank you for this opportunity to appear before you to address certain issues that have been raised in connection with the sale of insurance policies and financial products – including mutual funds, securities and other investment vehicles – in the military market. We, like you, have a strong interest in ensuring that these products are marketed and sold responsibly by responsible companies.

I. Background

As the Subcommittee is well aware, numerous types of financial products and insurance policies are sold to the men and women of the United States armed forces. These products and services range from mutual fund products to a variety of securities and other

investment vehicles to life insurance policies. The sale of these products is governed by specific regulations that have been propounded by the various branches of the military as well as other regulations, including certain state and local regulations.

As an initial matter, we believe that a good number of the products – including our insurance policies – that are sold to the military can be of great benefit to those who purchase them. We are troubled by recent reports of incidents that may have undermined public confidence in these products and the sales techniques of the companies that sell them to the military. We believe it is of paramount importance to restore public confidence and protect members of the military from non-compliant sales techniques.

We commend the Subcommittee on holding this hearing at this time. We believe that our company and, more importantly, our customers will benefit from a sales environment in which all salespeople and agents from all companies are in compliance with applicable regulations to the maximum extent possible.

In addition, we embrace and encourage all reasonable measures to help educate military personnel on financial planning and related matters. American Amicable – like so many companies that promote and sell insurance to the military – markets its products to a wide range of military personnel with differing backgrounds and levels of financial sophistication. We firmly believe that an educated customer base is beneficial to both our insureds and the industry as a whole because such increased financial education will help enable our servicemen and women to make intelligent financial decisions for themselves and their families. Those who understand our products and use them as part of a broader financial plan will be more likely to utilize the products' benefits and, consequently, hold the policies longer.

We further commend Representative Burns on the legislation he is sponsoring. We support those provisions of the proposed bill that pertain to insurance products. We welcome the clarification and strengthening of the role of state regulators with respect to on-base military sales and have no objection to the disclosure that the bill would require

insurance companies to make. Like Representative Burns, we oppose any deceptive and predatory sales practices on military installations. The other provisions of the proposed bill relate to investment products that we do not sell.

II. About American Amicable Group

American Amicable Group traces its roots back to 1910 when the Amicable Life Insurance Company was organized. Through the years, Amicable Life Insurance Company has experienced considerable growth, and today American Amicable Group is comprised of American Amicable Life Insurance Company of Texas, Pioneer Security Life Insurance Company, Pioneer American Insurance Company and Occidental Life Insurance Company of North Carolina. These companies employ over 110 individuals in the home office in Waco, Texas and have contracts with over 3,000 independent agents.

At American Amicable, we are proud of our organization, our employees and the services we provide to our valued policyholders. We have a longstanding tradition of offering innovative and reliable programs that meet the diverse financial needs of people in all stages of their life. Anchored by a foundation of financial integrity and responsible management, the American Amicable Group provides whole life, term and interest sensitive life insurance products to civilians, federal employees and members of the U.S. military in the United States, Puerto Rico, U.S. Virgin Islands, Guam, Anguilla, Cayman Islands, Europe and Japan. Currently, the American Amicable Group provides protection to over 180,000 policyholders whose side fund balances total over $86 million. We do not sell mutual fund products.

American Amicable has historically provided excellent service to its policyholders and their families. Over the past 20 years, the companies affiliated with the American Amicable Group have paid beneficiaries more than $428 million in death benefits across all lines of business. In the last year alone, we paid more than $8.2 million in death claim payments on policies issued in the military market, and in the past 5 years, we paid more than $37 million in death payments on such policies. To date, we have paid nearly $1.5

million in death benefits to the beneficiaries of service members who lost their lives in the current conflict in Iraq. As a result of the American Amicable Group's financial strength, A.M. Best, the leading insurance industry analyst, has given us (and all of our affiliated companies) a rating of B++ (very good).

III. American Amicable's Products, Compliance and Training

The Subcommittee has expressed an interest in knowing more about certain aspects of our business including our Horizon Life product, how we react to instances of potentially improper sales practices by agents on military bases, and how we train agents to sell our products.

Let me say at the outset that American Amicable does not condone the apparent violations of military regulations committed by certain of our agents at Fort Benning in 2002 and Camp Pendleton in 2003. Such conduct is inconsistent with our standards and policies, not to mention the certification we require our agents to sign pledging compliance with all applicable military, state and local regulations. We take these matters very seriously and already have expended a considerable amount of time, resources and effort to take meaningful steps to investigate these matters and take appropriate corrective action including, among other things, terminating the contracts of the agents involved, offering refunds to affected policyholders, developing new and improved compliance programs (which we believe will make us a compliance leader in the industry), and working with outside counsel on a company-wide investigation of agent compliance.

A. Horizon Life

Horizon Life is a multi-faceted innovative product that we are proud of, and we are pleased that we have this opportunity to describe it, explain how it works and enumerate the many benefits it offers our policyholders.

Horizon Life combines a 20-year level term life insurance plan that is paid-up in seven years with an annuity accumulation fund, which we call the "Horizon Life Fund" or the "Fund." Thus, Horizon Life provides a unique and balanced program that pays a life insurance death benefit and provides accumulation value through capital appreciation in the Fund.

The dual life insurance/accumulation fund aspect of Horizon Life has made it a popular choice for both our military and non-military policyholders. As a result, we have marketed the Horizon Life product in all of our lines of business since the product was first approved by state regulators in September 1993. About two-thirds of the Horizon Life policies have been sold to military personnel and the remaining third to civilians.

Horizon Life Is an Innovative Combination Product

Horizon Life includes two distinct, but complementary, elements that fill unique needs. First, it has a flexible life insurance component that allows purchasers to receive term life insurance coverage with a level death benefit. At the end of the term coverage (20 years), the coverage is renewable for another 20 years. In addition, the term coverage can be converted to a permanent life policy without the insured having to submit to a physical examination and without regard to the health of the insured. Second, Horizon Life has an accumulation fund component that allows policyholders to build cash value through their monthly payments. The accumulation is enhanced by additional contributions to the Fund, which can be made at any time without any loads or deductions. Let me explain how this works in more detail.

How it Works

In the first policy year, the insured's entire base contribution is allocated to life insurance and any additional amounts the insured elects to deposit, which many policyholders do, are allocated to the Fund. In years two through seven, 75 percent of the base contribution is allocated to insurance, and the other 25 percent plus any additional contributions are

deposited into the Fund. After seven years, the life insurance premiums are fully paid-up, and 100 percent of the contributions plus any additional payments are deposited into the Fund. Our typical policy is issued to a 20-year-old male and has a monthly contribution of $100. For the purpose of this document, we will call this our "Base Plan." In addition, the average policyholder also contributes an additional $25 per month to the Fund. For the purposes of this document, we will call this combination of the Base Plan with the additional contribution of $25 per month our "Average Plan."

As I will discuss in more detail below, the Fund is a unique vehicle that has no load (i.e., money can be contributed to the Fund at any time without any fees being deducted or other restrictions affecting that contribution) and a fairly high contractually guaranteed rate of return of 4 percent with the added benefit of a potentially higher rate of return. Indeed, the average rate of return on the Fund has historically been more than 10 percent a year since its inception in 1993, and right now, the Fund is paying 6.5 percent.

Because of the dual nature of Horizon Life, once the life insurance component is paid-up, a policyholder can stop making payments and the life insurance will remain in effect. While this would significantly limit the cash accumulation benefits of the product, it is an example of the flexibility of Horizon Life. In addition, as long as a policyholder is paying his or her premiums or has paid the life insurance component fully, if a policyholder dies, the beneficiary receives both the life insurance amount and the balance of the insured's Fund. That is a significant benefit compared to traditional "whole life" products, which pay only the death benefit, not the cash value.

Another benefit of Horizon Life is that at the end of the 20-year contract, the policyholder receives a full return of the paid life insurance premium, which significantly increases the policyholders' cash buildup. Therefore, assuming a policyholder keeps the policy in force for the full 20 years, American Amicable places an amount equal to the base life insurance premiums paid by the policyholder during the first seven years into the policyholder's Fund. Several other major insurance companies, including Fidelity and

Guaranty Life, AIG, Aegon and Federal Kemper Life, now offer insurance policies with this type of feature.

Another advantage of Horizon Life is the flexibility it offers policyholders at the end of the 20-year period. At that time, a policyholder has many alternatives to choose from based upon his/her own individual needs or wants. He or she can: (i) withdraw all of his or her funds (including the returned life insurance premiums) without penalty and use them for any purpose; (ii) renew the contract, including the life insurance for another 20 years without submitting to a physical examination and without regard to the insured's health; (iii) convert the policy to a permanent life insurance plan; (iv) allow the insurance to lapse, but make additional contributions to the accumulation fund, which will continue to grow at a guaranteed rate of return with a potential for a higher rate; or (v) stop making new payments, but leave the principal in the account to keep earning interest.

Other Special Features of Horizon Life

In addition to the features I just described, there are several other features of Horizon Life that make it a valuable product to our policyholders:

- Unlike the vast majority of life insurance products, the death benefit is guaranteed for war-related fatalities. Additionally, once a policy has been in force for a full year, the death benefit is increased by 50 percent in the tragic case of a combat-related death. In other words, the beneficiary on a $40,000 life insurance policy would be paid $60,000 if the insured died in combat. This is a very meaningful benefit to military personnel since many commercial products do not pay benefits for combat-related deaths, much less add 50 percent to the base amount for such deaths.

- While the death benefits of Horizon Life begin immediately, the total death benefits increase over time. For example, using our Average Plan, a 30-year-old male who purchased Horizon Life in 1994 would have a total death benefit of

$41,976 ($56,976 if he died in combat) at age 30 and would be projected to have a total death benefit of $73,379 ($88,379 if he died in combat) at age 40. Most level term insurance does not have a rising benefit, but rather remains at the initial level for the entire term of the policy.

- There is no tax penalty for early withdrawal. In addition, after 10 policy years, there is no withdrawal charge by the company. In the first 10 years, the withdrawal fee is only 5 percent. Moreover, the accumulation fund can be accessed at any time. In fact, many of our policyholders choose to access this money as it offers an opportunity to fund a college education, make a major purchase, supplement retirement income, or undertake home improvements more affordably than a loan or credit card.

- At any time, the policyholder may withdraw a lump sum or keep the principal on deposit and receive interest only.

- Additional payments to the Horizon Life Fund are accepted at any time without any loads, deductions or restrictions. In fact, other than the 5 percent withdrawal fee that applies for the first 10 years (as discussed above), no loads or charges are ever deducted from the Fund.

- The plan provides for guaranteed convertibility. In other words, a policyholder can convert the plan to permanent life insurance at the end of the term with the same premiums of a healthy individual, regardless of his or her health condition.

- Many of our Horizon Life policies are sold with additional term coverage. About 25 percent of military purchasers take advantage of this option to increase their insurance coverage for a relatively modest additional premium.

- Additional term insurance coverage is also available for all family members for as little as $3.55 per month.

- Many Horizon Life policies include a waiver-of-premium benefit that pays the insurance premium as well as the scheduled fund contribution in the event of a disability resulting in an inability to work.

Persistency and Lapse Ratios

According to data reported in *A.M. Best's Insurance Reports* (*Best's*), a leading guide to the insurance industry, there was a lapse ratio of 13.6 percent in 2003 for American Amicable Life Insurance Company's military and non-military policies combined. Based on our understanding of the formula used by *Best's* to calculate lapse ratio, we estimate that the 2003 lapse ratio for all of the American Amicable Group's companies was approximately 11.7 percent. While there is no separate lapse ratio calculated or reported for military policies (or Horizon Life) only, we estimate that the 2003 lapse ratio for our military business across all companies was approximately 13.5 percent (13 percent for American Amicable Life alone), which is consistent with the reported lapse ratios of our competitors. For instance, *Best's* reports that Colorado Bankers and American Fidelity, which are both significantly involved in the military market, had lapse ratios for 2003 of 18.2 percent and 12.8 percent respectively.

Comparison of SGLI with Horizon Life

Recently, the Horizon Life product has been compared to the Department of Defense's term life insurance plan called Servicemen's Group Life Insurance (SGLI) as if the two were competitive products. These comparisons are inappropriate. The two products have very different purposes and very different features. The Horizon Life policy is a supplement to – not a substitute for – the military-sponsored SGLI. As a result, we sell Horizon Life as a complementary product that provides benefits that are not provided by or available through SGLI, which offers only a death benefit.

In complementing SGLI, Horizon Life can be particularly attractive to military personnel who have purchased the maximum SGLI life coverage of $250,000 at a government subsidized rate but want additional protection for their family because Horizon Life is among a small number of commercial products that cover war-related deaths.

Horizon Life also fills the potential insurance void for individuals who choose to leave the military and therefore lose the subsidized SGLI coverage. While ex-servicemen and women can convert their SGLI coverage to Veteran's Group Life Insurance (VGLI), the premium will rise substantially over time. These premiums can become quite prohibitive as the veterans grow older. Because Horizon Life's insurance component is paid-up after 7 years, veterans continue to have the life insurance long after they have left the service without any increasing premiums.

Furthermore, if a soldier chooses to terminate his or her SGLI or VGLI policy after 20 years, he or she would have nothing to show for what they paid into SGLI and VGLI over those 20 years. Horizon Life, on the other hand, combines life insurance with an annuity accumulation fund, which means that after that same 20 years a Horizon Life policyholder has something to show for his or her 20 years of contributions. The following chart illustrates the projected cash value that would accumulate in the Fund assuming our Average Plan issued in 1994.

Projected Cash Values at Ages 30 and 40 for the Average Plan[1]			
	Using Actual and Current Rates	Using Current Rate in All Years	Using Guaranteed Rate in All Years
At Age 30	$11,976	$10,787	$9,778
At Age 40	$49,979	$47,748	$39,443

[1] This chart calculates the projected cash value for a policyholder's Fund after 10 years and after 20 years using three different rates of return. The first column uses the actual rates of return over the past 10 years, which were over 10 percent and uses the current rate of 6.5 percent to project the Fund's cash value in the next 10 years. The second column applies the current rate of 6.5 percent over the full 20 years. The third column applies only the guaranteed rate of 4 percent to all 20 years.

Another added benefit of Horizon Life is the policyholder's ability to withdraw money at any time. For instance, the same soldier discussed above who bought a Horizon Life policy 10 years ago would have built a cash value of $11,976 after just 10 years, and that money would be available at any time for any reason, including funding an education, buying a car or making a down payment on a home.

The cash accumulation program is a substantial benefit that can help young adults build a foundation for their financial future, without the risk involved in alternatives like stock mutual funds. It also provides a guaranteed rate of return of 4 percent on all payments that have been, or will be, made into the accumulation fund, which is better than any bank savings account or money market fund. Additionally, there is the potential that the rate of return will be greater than the guarantee – the current rate is 6.5 percent and has historically averaged over 10 percent.

Importantly, Horizon Life is not a mutual fund. American Amicable Group does not sell the high fee "contractual plan" mutual funds that have come under increased recent scrutiny or any other mutual fund products for that matter.

In summary, Horizon Life is a versatile life insurance product that complements the military-sponsored term life insurance by providing many additional benefits, including a return of the life insurance premium at the end of the policy, a guaranteed accumulation rate for Fund contributions, the option of providing additional contributions allocated to the Fund and flexible access to the money in the Fund.

B. Conduct of American Amicable's Independent Insurance Agents

In the past year, we learned that a few of our agents at Fort Benning appear to have used inappropriate methods in 2002 to sell our products. We believe this and another incident at Camp Pendleton in 2003 are not characteristic of our company or the industry. Since 1995, we have had more than 2,650 agents selling our products in the military market.

Less than one percent of those agents have been found by the military to be in violation of regulations regarding solicitation on military bases. While even a single non-compliant agent is one too many, military records reflect that the conduct of our agents is as compliant – if not more so – with applicable regulations than the conduct of many of our competitors' agents. We believe we have a solid track record of taking prompt and decisive corrective action – including agent termination – when we learn of agent misconduct. Indeed, we have disciplined agents for compliance deficiencies even absent any notification from the military.

What appears to have happened at Fort Benning and Camp Pendleton should not have occurred. We do not condone the conduct of the agents involved, and we apologize to those affected. In order to ensure that we have adequately addressed all concerns about the conduct of our agents, we have taken several actions, including retaining the law firm of Hogan & Hartson to conduct an independent review of the Fort Benning allegations and the operations of our other agents in different regions of the country. That review, which is ongoing, already has led to, among other things, the termination of certain Fort Benning agents' contracts, as well as a decision to develop and implement a more stringent and formalized compliance investigation policy designed to enhance – both in terms of speed and substance – the company's response to potentially inappropriate agent conduct in the future.

Earlier this week, we also announced a series of improvements in our compliance and complaint-handling procedures designed to position us as the industry leader in this area. The improvements include a rigorous procedure to audit independent agents in the field, including surprise inspections by an independent compliance team. We believe that this and the other procedures that have been and will be adopted will decrease the likelihood of non-compliant behavior by our independent agents in the future.

We are firmly committed to honoring and supporting our military and those who serve our country. And, we do not want a single member of our Armed Forces to ever feel taken advantage of by our products or by the agents who sell them. We also want to

make sure that all of our customers, including those in uniform, are given the information they need to make the right choices about insurance. In instances where regulations appear to have been violated, we believe that refunds should be provided to all affected policyholders who request them. Thus, we will offer refunds to soldiers who purchased the Horizon Life policy in an improper setting at Fort Benning in 2002. Similar actions, including terminating the responsible agents and offering refunds, were taken at Camp Pendleton.

C. Training and Compliance

We always have trained our agents to follow the rules and regulations applicable to their sales and sales-related activities on and off military bases. In the past few years, we have strengthened our agent training and compliance program and we continue to implement new policies to further ensure that the independent agents who sell our products know and follow all applicable regulations. To that end, we have taken the following steps as part of our effort to become an industry leader in the area of training and compliance:

Communications with Consumers

- To help ensure customer satisfaction, all money that is paid to American Amicable is refunded if, for any reason, purchasers change their minds and request refunds within 90 days after purchase, which is substantially longer than required by the most state laws.

- A statement of understanding, which explains the insurance purchase, is attached to the compliance materials provided to purchasers. This material is intended to ensure that service members fully understand what they have bought, the terms of the purchase, whom to contact if they have questions and how to remain in contact with the company. This is a long-term product. We want our policyholders to feel confident in the product they purchased and to contact us with any questions throughout the length of our relationship.

- We provide a toll-free number and customer service representatives to answer questions and address any concerns our policyholders may have. We also provide extensive information to our customers about their policies via our company website.

- We mail a confirmation letter to each military applicant at his or her military address immediately upon receipt of an application in our home office.

- On each anniversary of purchase, policyholders receive an annual statement that shows the value of their accumulation fund.

Continuing Education of Sales Force

- Every agent receives training in compliance with (1) DOD Directive 1344.7, (2) other regulations specific to the individual branches of the armed forces, (3) state regulations and (4) local base requirements. All agents are required to execute a certificate indicating that they understand and agree to abide by the regulations and acknowledge the consequences to them if they violate those regulations.

- Several years ago, we created a "Building Success" training program with emphasis on the off-base sales of our insurance products. As a result, the majority of our sales are now made off the military installation. This program is now part of our required training for agents in military sales. One of the key building blocks of this program is to stress to potential policyholders the importance of the long-term commitment to their insurance products as well as all their investments. This program also helps agents better match clients' needs with the right policy.

- We have a compliance manual that each new agent is required to read and sign. It includes a discussion of solicitation practices prohibited by DOD and all the service branches.

- We send numerous field communications to all agents reminding them of the importance of complying with all military sales regulatory requirements and the consequences of violating those regulations or our company's compliance policies.

- We believe in continuing education. In-person seminar presentations are given each time agents gather for meetings or conventions. Any changes to the regulations are immediately distributed for compliance.

- We recently hired Carl Ross, a retired Civilian Chief of Staff for Training – Naval Training Center, to review and build upon American Amicable's training program and to increase our emphasis on ethics, customer service, quality control and customer feedback. With the assistance of outside expertise, we expect to continue strengthening our training program.

In addition to what we are doing to try to ensure that our agents comply with DOD rules and regulations, as well as local and state regulations and our own compliance program, we support all reasonable measures that would allow military purchasers of insurance and all other financial products to make more informed decisions when purchasing those products and when using credit. As a result, we support an initiative by the American Council of Life Insurers and the National Association of Insurance and Financial Advisors called the "Best Practices for Military Insurance Sales & Their Function Regulation." The program is based on the notion that such education must be a joint effort among the companies, agents, DOD, service branches and state regulators. The program advocates a DOD-sponsored initiative of financial literacy for junior enlisted personnel to help them understand the differences among banking, securities and insurance products and services. Such education would be provided by a credentialed

instructor teaching from a standard educational program. We would be happy to work with these groups, as well as the Subcommittee, to take steps to ensure that our enlisted men and women are provided with the tools to make informed decisions about their financial future. It is in that environment that we believe our company, our products, and, most importantly, our customers will be most successful.

Thank you, Mr. Chairman and members of the Subcommittee for your time and attention today. We, at American Amicable, pride ourselves on our integrity. We assure you that we already have taken steps to address issues relating to the conduct of certain of our insurance agents and will take any additional corrective action that is warranted based on the continuing investigation we are conducting with the assistance of outside counsel. Additionally, we will gladly work with the Subcommittee to assist in the development and refinement of legislative measures that will strengthen customer knowledge and the sales practices of companies selling any financial or insurance products to members of the military.

If you have any questions, I would be pleased to respond to them.

Joe W. Dunlap
Personal Data

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Education

Sam Houston State University, Huntsville, Texas
BBA with major in Finance, 1978
Summa Cum Laude graduate

Fellow, Life Management Institute (FLMI), 1981

Chartered Life Underwriter (CLU), 1986

LOMA Associate, Customer Service (ACS), 1993

Chartered Financial Consultant (ChFC), 1997

Licenses

Registered Principal, National Association of Securities Dealers, 1983

Other

Corporate Secretary, American Amicable, 1995 to present

Member, American Amicable Board of Directors, 1991 to 2000

Former Chairman and member, LOMA Systems Development Committee

Former Chairman and member, LOMA Customer Service Committee

Past President, Waco FLMI Society

Joe W. Dunlap
Professional History

American Amicable Life Insurance Company of Texas
1978 to Present

Executive Vice-President, Operations
April 1, 2003 to Present
Mr. Dunlap is currently responsible for all operational areas of the company. These responsibilities include the policy administration responsibilities listed below along with all computer services and facilities management activities.

Vice-President, Policy Administration
1985 to April 1, 2003
Mr. Dunlap held responsibility for Underwriting, Policy Issue, Claims, Premium Accounting, Customer Service, Mail, Printing, Purchasing, and Supply. He was responsible for the reorganization and staffing of these areas in 1985 in conjunction with the relocation of the civilian business to American General. Key accomplishments and responsibilities included:

- Management of the above functional areas during the past 17 years on an effective and efficient basis while under a variety of organizational and ownership structures. Full time staffing in these areas has been reduced from a total of 101 in June, 1999 following the relocation and integration of Occidental Life to the current level of 54 full time employees.

- Coordinated the successful relocation of Occidental Life Insurance Company from Raleigh, North Carolina to Waco, Texas in 1998. The addition of the 120,000 Occidental policies more than doubled the in force policy count administered in Waco.

- Coordinated the successful relocation of National Public Service Insurance Company from Sacramento, California to Waco, Texas in 1988. The 32,000 in force policies increased the Waco in force by approximately 35%.

- Participated as a key member of system conversion teams involved in the conversions of AATX business from a home grown system to Life Comm in 1980, Pioneer American business from ALIS to Life Comm in 1982, NPS business from Cybertek to Life Comm in 1988, AATX Life Comm upgrade in 1999, and Occidental business from Life 70 to Life Comm in 2000.

- Provided management and direction for the majority of lawsuits against the Company by working with AATX general counsel and retained local counsel.

- Participated in the new product development process and provides input based upon knowledge of Company markets and products, underwriting practices, claims procedures, and system capabilities.

- Coordinated the Company's on-going operational improvement activities involving system and procedural enhancements. Mr. Dunlap works with the systems area and the various department heads to establish priorities for various projects.

- Coordinated the negotiation and acquisition of new reinsurance treaties by working with the actuarial, financial, and underwriting areas.

Assistant Vice President, Policyholder Service
1984 to 1985

- Mr. Dunlap managed the activities of approximately 55 employees and was responsible for all areas of customer service, including correspondence, policy changes, policy loans, and policy cancellations.

Manager, Policy Change Department
1983 to 1984

- Mr. Dunlap was the first manager of the newly formed Policy Change department which was created in an effort to eliminate substantial backlogs and processing problems. Work quality and timeliness were substantially improved through procedural improvements, process documentation, and employee training.

Manager, Administrative Services
1982 to 1983

- Mr. Dunlap was responsible for internal mail workflows and maintenance of company records and policy files. In addition to these duties, he was involved in several special projects for the Sr. Vice-President of Operations, including the conversion of the Pioneer American business from ALIS to Life Comm.

Management Trainee
1978 to 1982

- Mr. Dunlap was hired as part of the Management Training Program. Members of the program worked and trained in many areas of the Company in an effort to attain a comprehensive background in Company procedures and practices. In addition to assignments in all administrative areas, Mr. Dunlap also worked as a systems analyst and participated in various Company projects and system conversions.

Testimony of

Elizabeth W. Jetton, CFP®
Principal, Financial Vision Advisors, Inc.

on Behalf of

the Financial Planning Association®

on

"G.I. Finances: Protecting Those Who Protect Us"

Before the Subcommittee on Capital Markets, Insurance
and Government Sponsored Enterprises

of the

United States House of Representatives

September 9, 2004

Thank you, Chairman Baker and Ranking Member Kanjorski and members of the Subcommittee for this opportunity to testify today on the marketing of certain insurance and investment products to our enlisted men and women on military bases. My name is Elizabeth Jetton. I am a partner in an independent financial planning firm in Atlanta and hold the CERTIFIED FINANCIAL PLANNER™ designation. I appear before you today as President of the Financial Planning Association.

FPA represents more than 28,500 individual members who provide professional advice to individuals and their families or support the financial planning process. FPA recognizes the CFP® designation as representing the standard for competent, ethical financial planners as it requires a planner to pass a comprehensive examination, abide by a stringent professional code of ethics, requires annual continuing education and a minimum of three years' experience. FPA recently began a national community services program to provide pro bono financial planning to those in need and unable to pay for professional advice. As part of this program, we are currently in discussions with Pentagon representatives to see how we can provide pro bono advice to reservists and National Guards personnel called to active duty in Iraq.

To underline what I see as the purpose of this hearing, I was personally disturbed to read about the allegations of abusive sales practices to our men and women in uniform. I am particularly concerned about those who are young and starting out in their first career and who consequently may not have the more complicated insurance and retirement planning needs of an older person or know how to ask the right questions to determine their need.

I have been in the financial services industry since 1980, and have previously held an insurance producers' license. For the past 14 years, I have been in the practice of comprehensive financial planning and am registered with the State of Georgia Division of Securities as an investment adviser. I am also affiliated with a broker-dealer and am licensed to sell securities.

Financial planning differs from simply handling investment transactions. It is a six-step process. Investment and product implementation, including insurance, is one of the steps. Financial planning is an integrated process designed to help people make smart decisions about their money. It takes into account the various financial concerns an individual might have and seeks to find solutions that best suit their circumstances and goals.

In providing financial planning advice to clients to help them achieve their goals in life, it is incumbent upon a professional adviser to review their insurance needs as part of the overall plan. With respect to any kind of life insurance product, there are some basic questions that a consumer needs to ask about the product, particularly since life insurance agents are not required to comply with practice standards. Unlike on the securities side of the business, where NASD suitability rules come into play, or as an investment adviser, where you have a fiduciary duty to place the clients' interests first, the insurance agent has no statutory obligation to the customer for determining the suitability of the product to the individual's need.

Some of the questions that I, as a financial planner, ask my clients: First, is there a need for the insurance? Life insurance is recommended to replace the earned income of the insured for the benefit of his or her family, to provide funding for financial and life goals that the income would have provided for, such as college tuition. If a soldier is young and single, I'm not sure a life insurance policy is necessary, unless he or she has dependents or aging parents who need help or is concerned about declining health. If there is a more substantial need for life insurance because the soldier is married and has children then, depending on the age of his children, 10-year, 15-year, or 20-year level term insurance may be the optimal solution, because it can provide a sufficient level of coverage at an affordable price.

Second, if it is determined that there is a need for life insurance, how long is the coverage needed? Again, the answer is, it depends on the age of the insured as well as the individual's concerns, goals and financial priorities. If there are small children, the insured probably would want coverage to last until the children leave home. A needs analysis would look at the family's circumstances, determine their annual needs, and arrive at a lump sum sufficient to provide the required annual income to support the family if the insured died. Generally, an insurance company will provide a death benefit of up to 16 times an individual's annual income. Assuming that the soldier is 30 years old, enlisted for 6 years, his income would be roughly $30,000. He may already receive $250,000 of insurance from the U.S. Government. Another $250,000 in 20-year term insurance with an A+ rated company could be obtained for as little as $167 a year, and a $250,000 universal life policy from a reputable company might cost $1,077 per year.

In contrast, according to information provided FPA by this Committee, a so-called "seven pay 20 year level term" life insurance policy being marketed on military bases -- with a death benefit of just $29,949 -- has a premium of $900 in the first year decreasing to $675 in each of the next six years. The cash value of this plan is zero for the first three years, increasing to $407 in year seven, and then decreased back to zero by the end of the 20-year term.

These early year high costs come at a time when the soldier and his or her family may be struggling to cover the costs of raising a family and keeping up with their overall cost of living on a limited income. Life insurance is just one of the financial demands they face. When considering life insurance for individuals with young families trying to stretch their income, we look for the best and highest death benefit with a highly rated, reputable company, for as reasonable a price as possible. Financial planners will typically consider a least four different insurance companies when reviewing quotes for coverage.

Cash value life insurance is often pitched as a retirement solution. In the case of the military in particular, we believe this approach is misguided and misleading. The primary rationale for purchasing life insurance must be to protect one's family from the economic consequences of the breadwinner's death. Any reference to retirement planning only confuses the issue. I would strongly suggest to you that any disinterested third party would have a very difficult time justifying life insurance as rational retirement investment for the typical serviceman.

If a retirement planning solution is being pitched through a cash value life insurance policy, one must first look at how the cost, including insurance administrative charges, sales commissions, and potential early cancellation penalties compare to buying basic term and investing the rest.

There is a saying that "if all you have is a hammer, everything looks like a nail." In other words, the unscrupulous insurance salesman who has only life insurance to offer will try to solve every financial issue with an insurance product. A financial planner, who must put the interests of the client ahead of her own, considers what investment tools are most appropriate given the financial constraints and priorities of the client. One must then look at the insurance companies' projections and determine whether or not those projections bear any resemblance to reality. As a professional, I may be able to make that determination; I can assure you that the average enlisted man or woman cannot.

Cash value life insurance is typically appropriate for those who first of all have a permanent, lifetime insurance need, who can afford the higher premiums and who can benefit from building-up cash value that could be used for life benefits, assuming they have maxed out contributions to other retirement plans.

I also feel compelled to comment about other investment products that are marketed on military bases. Should a member of the military purchase the life insurance policy I described earlier, he or she would also be entitled to invest in an "annuity accumulation

fund" which, according to the company's documents, generates a negative return in the first two years and has a 5 percent early withdrawal penalty during the first 10 years. This annuity fund would simply not be viable in the civilian marketplace, and we wonder whether information is adequately disclosed about the costs and lack of liquidity of this annuity, as well as the fact that the funds are not generally available before age 59 ½ without additional penalties imposed by the IRS.

We are also concerned about the marketing of certain types of mutual funds known as "contractual plans" on military bases to less sophisticated and lower ranking members of the military. This type of fund has sales charges that can consume 50 percent of an investor's first-year contributions and are seldom the best investment product for these members of the military. The NASD imposes limits on mutual fund sales charges to 8.5 percent, but these charges rarely exceed 6.5 percent. In my experience, civilians working with reputable financial advisors typically pay no more than 5 percent of the first year's investment on a mutual fund purchase.

Conclusion

If the reports of sales abuses on the military bases are accurate, then it is hard to imagine a more terrible way to send off our men and women to war since they deserve and need financial guidance for themselves and their families in their absence.

When our soldiers are convinced to purchase inappropriate and excessively expensive life insurance and investment products, it may mean that other financial needs go

unaddressed. If the news reports are accurate, and those who most need basic financial services to protect their loved ones and their futures are being taken advantage of by companies that are getting access to these men and women in the guise of providing financial education seminars, FPA believes it would be prudent for Congress to consider restricting the sale of contractual plans and granting states the authority to regulate insurance sales practices on military bases.

I hope that my testimony helps to distinguish between unscrupulous salespeople, who are not required to abide by either NASD suitability standards or the higher professional fiduciary standard for registered investment advisors. I appreciate this opportunity to clarify how professional financial planners go about the business of caring for individuals' financial needs and appreciate you attention.

Thank you for holding this important hearing. FPA looks forward to the opportunity of working with the Committee on this issue. I am happy to try and answer any questions that you may have.

STATEMENT OF GOVERNOR FRANK KEATING,

PRESIDENT OF THE AMERICAN COUNCIL OF LIFE INSURERS

BEFORE THE U.S. HOUSE OF REPRESENTATIVES

FINANCIAL SERVICES SUBCOMMITTEE ON CAPITAL MARKETS,

INSURANCE, AND GOVERNMENT SPONSORED ENTERPRISES

REGARDING

"G.I. FINANCES: PROTECTING THOSE WHO PROTECT US"

9 September 2004

Good morning, Mr. Chairman and members of the Subcommittee. I am Frank Keating, President of the American Council of Life Insurers. I much appreciate the opportunity to appear before you today to discuss how best to address unscrupulous sales of financial services, including insurance, to our men and women in the military service. You are to be congratulated on conducting this expeditious hearing. We at the ACLI are glad that the revelations of this summer have finally opened communications among those whose responsibility it is to solve the reported problems. For more than a year the ACLI has been aware of allegations of misbehavior. We have sought attention for them at the highest administrative levels. We had ideas for solutions to share with you today. We believed we had achieved a breakthrough earlier this year when we were able to sit down with representatives of the U.S. Government Accountability Office to help them plan their investigation into the accusations leveled by all sides. We encouraged the GAO to dig deep beneath its express mandate to get to the bottom of things. But it was the stories published by *The New York Times* in July that rocked everyone out of complacency and into remedial action. It is about time.

The telling thing about the newspaper's stories is that the news was old news. Many of the same allegations involving the same companies were reported four years ago in the Cuthbert Report, which is the unofficial name of the official Defense Department investigation into "Insurance Solicitation Practices on Department of Defense Installations".[1] While that report itself is controversial, it was clear long before it was

[1] Final Report to the Deputy Under Secretary of Defense (Program Integration), May 15, 2000

published that something was amiss in the supervision of insurance sales to military personnel. It should have been clear that alleged insurance problems required something of state insurance regulators as well as Defense officials. Our military mobilization since September 11 accelerated personal financial planning for our newly enlisted, accelerated sales of insurance, and perhaps accelerated incidents of coercive selling. But it did not accelerate communications between industry and Defense officials and state insurance officials – until now.

The ACLI and the National Association of Insurance and Financial Advisors (NAIFA) have shared with you for this hearing a dozen *Best Practices for Military Insurance Sales and Their Functional Regulation*. Our recommendations are divided into three areas. The first area addresses military installation market conduct by insurers and insurance agents. The second area recommends improved, standardized financial literacy opportunities for our servicemen and women. The third area recommends improvements in regulatory supervision of the military market for insurance sales. Thus we offer suggestions for improvement for both industry and regulators. We have more ideas to offer and we are actively soliciting suggestions from our member companies and agents. We want to assure that our military servicemen and women have the education, information, safeguards and independent sources of advice necessary for their individual needs. No industry can endanger its fundamental enterprise by tolerating misconduct in its core activities. We surely do not want our many good companies and agents unfairly tarred by a brush intended for a few. That is why ACLI is here today and anxious to help you sort

out the regulation of military sales of life insurance. We are convinced that the reason these issues continue to come up is because of the lack of clarity over who has the authority to oversee such sales and the absence of clear procedures to ensure the highest standards for dealing with men and women in uniform.

I might take a moment now to address remedial legislation drafted by the Honorable Max Burns from the State of Georgia. At the heart of that legislation is the genuine solution to many of the problems reported in the press–state regulation. That solution involves the realization of genuinely functional regulation – in both the technical and common sense of the term. There are a few ancillary provisions in the bill to which I would like to suggest improvements.

First, the bill intends, we believe, to prohibit a particular investment product known as contractual mutual funds. As this is not a life insurance product, ACLI has no opinion about the pros or cons of such investments. However, the description of the product in the legislation goes far beyond contractual mutual funds to prohibit all kinds of insurance and annuities that have a variable element in them. ACLI has communicated with the Committee's staff on how to refine the technical description in the bill to the controversial product under your review.

My second observation is that the notion of asking 50 state insurance regulators to implement *new* standards to protect military personnel from insurance sales misconduct is unnecessary and probably unwanted by all the regulators involved. It has been the

absence of any kind of functional regulation of insurance sales on military installations that has created cracks through which misbehavior has reportedly taken root. Further, it is in the complete absence of effective enforcement of all relevant rules that has caused some of our soldiers to become victims of scams.

Fifty new state rules in addition to existing rules will *not* better protect our servicemen and women if neither the states nor the Defense Department can enforce any rule. The military services are a unique environment: It is populated by highly mobile individuals who have special needs and a healthy respect for those in authority or who otherwise provide guidance. The functional regulation of insurance by the states must be reconciled with the functional regulation of our military personnel by the Defense Department. ACLI believes that the balance can be achieved by:

1. Centralizing financial services supervision of all military services within a particular command in the Defense Department; and
2. Looking to that centralized defense command to serve as the liaison and coordinate financial service sales supervision, handle complaints, and provide regulatory enforcement with the financial service functional regulators.

Under this approach, an infraction by a sales agent or company on a military installation is not an isolated incident receiving an arbitrary evaluation. Rather it becomes an incident reported to multiple regulators and multiple installation commanders; it is subjected to fair and certain adjudication; and it could result in license revocation or penalties that

sting. The cracks in the system become sealed and misbehavior is rooted out, not to find fertile ground on another installation or in another state or foreign country.

Thank you, again, for allowing me to address you on these important topics and ideas. I assure you that the members of the American Council of Life Insurers are eager to help you address effectively the problems now under investigation by the GAO. We very much believe we can be part of the solution, and that our recommended best practices provide a path to success.

Respectfully submitted,

FRANK KEATING, President
The American Council of Life Insurers
Washington D.C.
Telephone 202.624.2000

Attachment:

Best Practices for Military Insurance Sales and Their Functional Regulation Proposed by the American Council of Life Insurers (ACLI) and the National Association of Insurance and Financial Advisors (NAIFA)(9 September 2004)

The American Council of Life Insurers
The National Association of Insurance and Financial Advisors

Best Practices for Military Insurance Sales & Their Functional Regulation

Military Installation Market Conduct

The Defense Department should consult with the Insurance Marketplace Standards Association (IMSA) for guidance on the ethical standards of insurers and their insurance producers. IMSA was established to help address public concerns about insurer market conduct and has established insurer assessment programs contributing to improved insurer operations and marketplace practices. IMSA maintains appropriate independence from other insurance trade associations to assure confidence in its mission. IMSA likely has programs and standards immediately useful to the Defense Department as a first check of the integrity of an insurer seeking access to military installations. IMSA membership or insurer completion of an IMSA assessment could serve as a credential offering a *prima facie* degree of confidence and "fast pass" access, even while not constituting a requirement for access, to military personnel. A company not willing to become an IMSA member or submit to assessment would not be barred from access but might simply not enjoy the presumption of competence attributable to IMSA qualification, thereby warranting more particular review prior to gaining access privileges.

Each military installation should have locations designated for investment or insurance sales interviews. Disturbing reports of high pressure selling in dormitories and barracks might be addressed by the designation of locations appropriate for meetings between financial service advisors and potential or existing military clientele. The installation commander would likely be the best positioned for such determinations.

Every financial advisor or insurance producer should establish his or her identity as such via a business card given to each serviceman or woman contacted. It takes just a business card with the financial advisor's name, company, address, phone number and/or email contact, and state of insurance license to assure a serviceman or woman that he (or she) knows with whom he (or she) spoke about an insurance product, how to find the advisor or agent again, or how to identify to supervisors an individual trying to sell "out of bounds". The certainty of agent's identification also permits authorities to screen the individual, e.g., against the NIPR Producer Database.

Emphasize the insurance "Free Look" benefit. Insurance policies provide a distinctive benefit to consumers, an opportunity to exercise "buyer's remorse" and cancel a contract days after one receives the finalized policy. The time period ranges from 10 to 30 days, depending upon state law. It is a perfect time to review the policy and evaluate any change in terms, conditions and rates. Military service personnel purchasing an insurance policy should acknowledge at the time of sale that they understand they will have the

advantage of the Free Look period, as well as the opportunity to consult with an advisor other than the insurance agent during that time.

Insurers and producers should offer the opportunity for post sale evaluation of product and sales process. Life insurers routinely survey newly insured individuals about their understanding of the product they have purchased, the reason for doing so, and their evaluation of the sales process. Insurers and producers seeking to sell life insurance to military personnel on post might create a survey form for specific use on military installations. In addition to insurers and producers, survey results should be shared with state insurance regulators and appropriate military installation personnel.

Financial Literacy

The Defense Department should be encouraged to provide basic financial literacy programs for junior enlisted personnel. Such programs might provide, e.g., one hour per financial sector of basic introductory information to the differences between banking, securities and insurance products and services, and be provided by a credentialed instructor from a standard educational program. ACLI and NAIFA recommend the Life and Health Insurance Foundation for Education (LIFE) as a source of a basic educational program immediately available and capable of providing fundamental education about life insurance products and services. LIFE has offered to work with the Defense Department to provide basic education on life insurance use and products. LIFE already provides such educational material to 25% of high school juniors and seniors around the country. The investment and banking sectors may also have educational programs that might be easily obtained for Defense Department utilization.

Financial advisors and insurance agents aspiring to sell products on military installations might be expected to be familiar with military sales rules and installation access protocol. Every state requires insurance agents to pass educational requirements in order to obtain a license. Some states require pre-licensing education and most states require continuing education of their insurance agents. Indeed, insurance producers are among the most educated and regulated sales individuals of all American industries. Yet an insurance producer or investment advisor might not have reliable guidance with regard to military installation access protocol or Defense Department rules for selling financial services to our troops.

Defense Department financial service educational programs might be separated from selling opportunity. If GAO investigators confirm that events billed as opportunities for financial services education have been misused to coerce product sales, consideration might be given to separating educational from sales opportunities by time or space.

Functional Regulation

Centralize insurance supervisory activities within the Defense Department. Every complaint about an insurance producer or insurer communicated to a state authority or resulting in a military installation sanction might be communicated to an individual or office within the Defense Department who can coordinate disciplinary activity with all regulators and all military installations. This office, over time, will be able to develop oversight of patterns or practices that might be further evaluated for propriety and addressed effectively by military directive. Centralized Defense Department supervision might provide liaison between every installation commander and state insurance commissioners, as well as field insurance inquiries and complaints arising from insurance sales activities whether they occur on or off the military installation.

Resources might be authorized for the Defense Department to subscribe to the National Insurance Producer Registry (NIPR). The NIPR is a subsidiary of the National Association of Insurance Commissioners (NAIC) that maintains a Producer Database of about four million (4,000,000) licensed insurance producers in the United States. The Defense Department can obtain instant access to every insurance producer in the country, including whether a producer's license has been suspended or revoked in any state, by subscribing to the NIPR.

Defense Department Directive 1344 regarding Personal Commercial Solicitations should be synchronized with established financial services functional regulation. The persistence of financial service problems on military installations suggests that relevant Defense regulations might obtain value added by the regulators with expertise in the different financial service sectors. Revisions to Directive 1344 should be vetted with the functional financial service regulators. Coordination between Defense Department financial services supervisors and financial service functional regulators could successfully leverage regulatory strengths.

State insurance regulation applies to military installations. Just as federal banking regulations are applicable to depository institutions located on military bases so, too, are state insurance regulations applicable to producers and companies engaged in the business of insurance on military installations or selling to active military personnel.

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Written Statement of Lamar Smith
Chairman and Chief Executive Officer of
First Command Financial Planning, Inc.

on

GI Finances:
Protecting Those Who Protect Us

before the

Subcommittee on Capital Markets, Insurance
and Government Sponsored Enterprises

of the

Committee on Financial Services
U.S. House of Representatives

September 9, 2004

INTRODUCTION AND OVERVIEW

First Command Financial Planning, Inc. appreciates this opportunity to provide testimony on a subject of importance to us all. I am Lamar Smith, chairman and chief executive officer of First Command. It is my privilege to lead this 100 percent employee-owned company that is the single largest provider of financial plans to military families.[1] We currently serve 305,000 client families including 129,000 on active duty. These clients include more than 40 percent of the general and flag officers, more than 30 percent of the warrant and commissioned officers, and more than 16 percent of the senior non-commissioned officers.

Please allow me to commend Chairman Baker and members of the Capital Markets Subcommittee of the House Financial Services Committee for this public review of financial products and services being offered to our men and women in uniform on military installations. This is a topic of great importance and one on which First Command provided more than a year ago on-the-record reform recommendations in oral and written testimony to the Defense Department "Town Hall" Meeting on military solicitation regulations.[2] We have consistently called for improvements in the current rules, and we renew that call today.

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[1] – "First Command Capturing the Military Market, an Analysis of the Financial Plan Market within the Military Community," August 2004, DALBAR Inc.
[2] – "Comments Regarding Revisions to DoD Directive 1344.7," August 2003.

American families today face significant challenges in achieving long-term financial goals while maintaining both an acceptable lifestyle and financial security en route. The military is a microcosm of the U.S. populace with the same challenges to the pursuit of financial success and security. Evidence of low savings rates, inappropriate personal debt burdens, near-record personal bankruptcies and finance-related family violence speak to this problem. Possible solutions include increased education, increased protection and increased motivation to personal responsibility. Available tools for the military community include free training and guidance, such as that offered by the First Command Educational Foundation, which is described more fully in this statement; self-help on the Internet; and companies such as First Command that offer products and services for sale. No one has found the "silver bullet" that meets every need. But whatever solutions are explored to protect those in uniform, products, services and support that can create a secure path on which they may pursue their financial goals must also be available.

For a moment, step outside the military. How many people in mainstream America have the knowledge, self-awareness, ability and discipline to establish and then achieve financial security? As a 29-year-old Air Force captain in 1977, my skills were that of a combat pilot and later an instructor pilot in our training system. I had been in no way prepared even to evaluate my personal financial situation, let alone to create a path that would allow me to pursue significant financial goals and to provide security for my family along the way. My wife and I were trying but had poor products with confused objectives and little prospect of success until First Command offered its planning structure. We benefited greatly from our First Command agent sitting with us for several hours offering us a much better opportunity to succeed. In fact, like the majority of First Command representatives it was this positive experience that led me to affiliate with the company.

By appearing here today, First Command Financial Planning hopes to provide insight from our long experience in dealing with the financial interests of military personnel. But first allow me to correct a picture of First Command that may have been created by recent media reports. We have received many indications from our clients, prospective clients and military officials that these reports created an unfortunate and misleading impression about us. Articles have detailed allegations of sales practices targeting junior enlisted service members with questionable insurance products. While bringing attention to areas of possible abuse, the stories have been understood by many to erroneously associate First Command with such sales practices. Let me be absolutely clear on the following points:

- First Command does not solicit business from junior enlisted service members.[3]

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[3] –Even though First Command does not solicit junior enlisted personnel, our client base of 305,000 client families includes a small number of these individuals. In almost all instances these are children or other relatives of existing clients who have requested that they be covered by our services.

- Our market is the military's leadership ranks.
  - In terms of pay grades, that is E-6 through 0-10
  - In terms of rank, that is senior sergeants and petty officers through general and flag officers.
  - In terms of active duty status, that is senior non-commissioned, warrant and commissioned officers.
- First Command does not recommend life insurance for savings or investment purposes.
- First Command does not attempt to use command influence to create selling opportunities. Our Board of Advisors is just that – advisors to senior management who keep us in touch with the needs of the military community. The notion that they are involved in any way in our sales process is not true. The men and women on our Board of Advisors each enjoyed long and distinguished careers, some rising to the pinnacle of their respective services. They now work successfully in post-military careers, many continuing to serve in capacities that keep them positively involved in the military community. It would be unfortunate if anyone inferred that these honorable individuals would take any action or support any organization that did not act in the best interests of service members.
- We do not sell in mass meetings or at mandatory formations.
  - Our products are offered in the context of a recommended Family Financial Plan that addresses long-term goals, short-term needs and emergency considerations.
  - The plan is only recommended following multiple appointments spanning many hours. For couples, both spouses are present at the appointments whenever possible.
  - First Command representatives are not allowed to sell products to first-time clients outside of the planning process.
- We stay closely attuned to our clients and market for indications of how we can do our job better.
- We are honored to count more than 20 percent of our potential market as clients and to have a more than 90 percent approval rating from them.[4]

Those in our segment of the market are mature, experienced, educated, responsible men and women. We would not enjoy the satisfaction ratings we do if we did not serve them professionally, ethically and effectively. The picture that many readers derived from the media articles is not the true picture of First Command.

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[4] – "First Command Financial Planning Client Satisfaction Survey," conducted by National Service Research, February 2003 and April 2004.

Components of a Family Financial Plan

First Command's Family Financial Plans include recommendations for life insurance, bank-based savings, and long-term investments. In both the insurance and banking recommendations our products and services are among the best in the industry.

- Insurance - Where appropriate, our recommendations can include whole life insurance to supplement the military's term insurance.. We believe insurance is for creation of an immediate estate if the plan holder should die prematurely. We do not recommend life insurance for savings or investment purposes. The insurance we offer in this regard is among the most competitive in the military marketplace. Features of the insurance we recommend include:
  - No war clauses – to ensure that the terms of the policy will be met even if war was the cause of death.
  - No aviation clauses – Similar to the war clause, some insurance policies exempt the policy from being fulfilled in case of death resulting from an aircraft accident. None of the policies we recommend have such an exclusion.
  - Options for no aviation rate ups – First Command has negotiated with one of the insurance companies it represents to offer a policy that does not automatically increase the premiums on aviators.
  - Our options to purchase additional insurance are guaranteed options every three years to age 40 no matter what physical condition the client is in at the time of the option and no matter where they are or what they are doing. These options can be extended to age 49 by accepting a minimum requisite number of the pre-age 40 options.
  - We have negotiated very favorable premiums on these policies with our carriers based on our industry leading persistency (policy-retention) rate.
- First Command Bank – Established in 1998, First Command bank was designed specifically with the needs and lifestyles of military consumers in mind. First Command recognizes that debt – when under control – can be a useful tool in personal financial management. We strive to offer banking products and services that compete favorably with any financial institution serving the military market.[5] And judging by the fact that the bank is gaining well over 1,000 new customers a month, we seem to be achieving that goal.

Because First Command offers insurance products tailored to the specific needs of our military clients that compete favorabl y with any in the market and because First Command Bank offers competitive rates for products and services compared to its peers in the community, it is self-evident that First Command offers only the investment products and services that are tailored to be in our clients' best interest?

[5] – "Military Bank Comparison Chart," August 2004 (attached) shows First Command rates compared to a number of banks serving the military market.

THE NEED FOR MILITARY FAMILIES TO HAVE A FINANCIAL PLAN

As stated above, First Command is not active in the junior enlisted market. However, we are concerned about these men and women. The First Command Educational Foundation, about which I will say more later, has as a significant part of its mission the goal of helping these young people develop sound personal financial habits.

The savings rate of Americans is around 2 percent (closer to 1 percent for the first half of 2004).[6] Personal bankruptcies for the year ended June 30, 2004, were almost 1.6 million, the second-highest figure recorded.[7] These issues are present in the military community just as with the civilian sector. In fact, it could be argued that the effects of financial stress – regardless of its source – are heightened in the military as a result of the high operations tempo, frequent and lengthy family separations, and attendant stresses of a military at war. The Department of Defense has recognized this and has started programs of its own and partnered with outside organizations to offer financial education and to motivate service members to pursue financial well being. [8]

We too believe and have built our business on the fundamental tenet that it is critical to help military families develop habits that provide them the tools, ability and motivation to pursue achievement of significant financial goals with the highest available level of security as they do so.

POSSIBLE WAYS AHEAD

In suggesting the need for greater financial knowledge and planning, we recognize that the media reports mentioned above address allegations of questionable sales practices especially targeting junior enlisted personnel. Also as noted above, First Command is already on record supporting DoD reform of solicitation regulations, and we would also support codifying some of these reforms in legislation.

A possible system that could address the problems would include:

- requiring those in the most vulnerable ranks (likely E-1 through E-3) to meet with a supervisor or installation counselor prior to signing an allotment form affecting their pay. This meeting would allow the junior enlisted person a broader view of the product or service under consideration. While respecting

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[6] – U.S. Bureau of Economic Analysis, http://www.bea.gov/briefrm/saving.htm

[7] – Administrative Office of the U.S. Courts, http://www.uscourts.gov/Press_Releases/june04bk.pdf

[8] – *American Saver* online magazine, *Military Saves Campaign Underway* http://www.americasaves.org/back_page/american_saver1.cfm

the service member's freedom of choice, this would also fulfill what we see as the military's obligation to seek the best interest of its young men and women.[9]

- creating a DoD registry of agents and the companies they represent (the company responsible for agent appointment and, therefore, agent conduct). If an unscrupulous agent is identified, that person can be stopped at all installations. This would also allow military officials to identify patterns of abuse by more than one agent of one company.
- As we mentioned in our DoD testimony, requiring companies to provide lapse rate data on products sold that shows how many purchasers cancel their products. Such a system would make much of the monitoring issue more self-policing because the lapse rate is the voice of the marketplace on the benefits and quality of insurance. The data could be an indication of how military members rate products and services with the assumption that individuals, over time, will not keep products that do not offer them value.
- We will also make a suggestion regarding the sale of Systematic Investment Plans discussed later in this document.

Attacking the bigger problem

But what of the need to improve the personal financial habits of those in uniform? Creating educated, motivated consumers acting knowledgeably in their own best interest is the true long-term solution to this problem. What has been done?

The military community has resources to help in this regard. Most installations have a financial services center that provides training and counseling to service members and their families. Additionally, each military unit has a person in a leadership position tasked with financial education and, when necessary, crisis intervention.

First Command has been active in support of these efforts. In 1983 – 21 years ago – we created what would become the First Command Educational Foundation. Initially, the Foundation, funded by the company, its agents and members of the company founder's family, offered scholarships to children of active duty parents. To date, the Foundation has awarded more than $2.7 million in scholarships.[10] In light of the issues we are discussing today, the Educational Foundation was reoriented four years ago and

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[9] – Such an arrangement need not be limited to financial products. Many vendors solicit from among those in the military with limited life experience, often for major purchases and commitments. Automobile sales, major electronic purchases and furniture are a few.

[10] – First Command Educational Foundation Web site. www.firstcommand.org. *It is important to note, neither First Command nor the Foundation, chooses the recipients of scholarship dollars. Selection is left to local organizations such as spouses clubs who know best where the money would do the most good. Additionally, the Foundation's personal finance classes are conducted only at the invitation of local military commanders.*

restructured as a fully independent, non-profit organization. The First Command Educational Foundation expanded its mission and began as a primary focus to offer generic, non-commercial financial education to service members and financial training officials in the military. Through a worldwide team of trained volunteers, the Foundation provides classes on personal finance in almost any non-combat area where U.S. military members are stationed. The training is offered to all ranks but is tailored to be especially beneficial to junior personnel. Additionally, the Foundation offers "training the trainers" instruction for military finance counselors. These instructional offerings have received outstanding reviews from participants and are provided free of charge. Again, these are generic, non-commercial presentations that do not tout any product or push any philosophy other than a commonsense approach to financial stability by living on less than you make and regularly investing and saving.

In times of tight budgets and combat-related responsibilities, the military cannot devote the dollars it might like to financial education. First Command Financial Planning continues to support the Educational Foundation with funding and expertise. As will be discussed below, it is imperative that military leaders, particularly in the non-commissioned officer ranks, be able to put their own financial houses in order so as to offer worthwhile help to their subordinates from a position of strength and experience. But even with help from various educational foundations – First Command's and others – the need exceeds the resources to meet it.

To be sure, education is valuable, but even if adequate educational resources are found, is that the answer to the current problem of personal financial behavior? It does not seem so. In the Internet age, almost limitless information is available to consumers at any level of sophistication. Additionally, personal financial information abounds in the forms of magazines, television programs and newspaper stories. If adequate information were the key the problem would be solved. Unfortunately information alone is not the key. We have a saying at First Command: Information is not knowledge. Knowledge is not Wisdom. You must not only have data, you must have an understanding of the data. You must not only have an understanding of the data, you must have the judgment to act on it. You must not only have the judgment to act, you must act. Education is valuable and should not be underestimated. But it is not the only answer.

For help in time of need, military members can turn to their chain of command. As stated above, First Command has been active in the military market for 45 years. In that time, we have had the opportunity to view the personal financial reality of literally hundreds of thousands of military families. We only solicit business from the leadership ranks, so we only see the financial situations of those in leadership positions. All too often, these individuals are in need of help just like the ones they might be called on to counsel. It is not uncommon for even those in the military leadership ranks not to have a clear financial goal or consistent activity in place to build meaningful wealth.[11]

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[11] – "Average Financial Position of Selected New and Existing Clients," (attached).

Information and education are not enough. If they were, we would see more evidence of positive results in the financial lives of military members. What then is the solution?

WHAT HAS WORKED FOR MANY MILITARY FAMILIES

There is no shortage of products available to today's military families. Anyone can invest in stocks through an easily established Internet trading account. Anyone can invest in a mutual fund the same way. Insurance is available online, by phone and through numerous agents who focus on the military. The military itself has "products" through its Servicemembers' Group Life Insurance and its version of the Thrift Savings Plan. If individuals have the knowledge to evaluate their own budget; the self-awareness to envision short- and long-term financial goals; the ability to calculate present and future value of the those goals; the skill to choose the right products with which to pursue the goals and to choose the right products to protect against emergencies or death; the discipline to stay on the path they have established, possibly for decades; and the ability to evaluate their progress and direction and make necessary adjustments, then they need very little help, from First Command or any other company.

So how do people without the abilities above try to move from where they are to where they want to be? Those with significant assets get help . . . a knowledgeable financial partner to serve as a guide or coach on their financial journey.

Allow me to offer an illustration. The image of building a house seems pertinent here. Most of us know a little about real estate, about design, about construction, but very few of us refuse all help and select and buy land; design a structure; and then build it ourselves. We get knowledgeable professionals to help us. The same can be said of taking care of our health. If we suspect something is physically wrong, we seek professional medical advice. Unless particularly skilled in the care of today's computer-based cars, we seldom even work on our own autos . . . we get help.

Is a prudent plan to pursue well-conceived financial goals any less important a project than maintaining a car or taking care of your health or building a house? It has seemed odd to me that as the ease of access to financial products and services has grown, particularly through the Internet, the assumption has grown with it that everyone should be able to do it on their own. Do some? Of course. But I believe the more typical experience can be compared to one of our clients, a top-ranking sergeant stationed at Fort Hood, Texas, who recently said: "I don't want to have to read the business pages. I barely have time to read the sports pages."

We are at war. Our service members are busy. Many are in hostile situations. Many have neither the time nor inclination to create, monitor and adjust a financial plan. They want help, they are willing to pay a fair price for it, but where are they going to get it? All too often, because of the demands of military life or the reality of the "can-do" military culture, those who need help do not seek it. In many cases, companies that offer financial advice are likewise not providing the level of service required by military consumers because the dollars available for dedication to a financial plan do not generate sufficient

return to the financial advisor for his or her time. The result is that many times those in need of help do not connectwith those who can help because of th e gap between what the market says the help is worth and what the prospective client can afford to pay. Where is a method to break this cycle?[12]

Systematic Investment Plans

For about a year now one of First Command's principal regulators, the NASD, has been closely looking at virtually all phases of our operation. This investigation is almost concluded, and we are in the middle of discussing its findings as well as an appropriate disposition of the matter. The NASD main concerns apparently relate to how we market our plans. Since publication of *The New York Times* articles in July the SEC has also started an investigation.

As I think you can understand this is a very sensitive time for First Command. I would have preferred that these hearings occur after resolution of these regulatory issues. However, because these hearings have been scheduled during this active regulatory period, I am constrained as to what testimony I can provide concerning First Command activities that are under scrutiny. As you can appreciate, the discussions we are having with our regulators are being conducted in a non-public forum. This is the traditional way such discussions are conducted, and it is necessary if there is to be a productive and appropriate resolution. We would be pleased to discuss the matter with your counsel privately, if you want us to.

This will not deter me from exploring with the Subcommittee possible suggestions or recommendations in general for improving the marketing and sales of these types of investments.

Features

Systematic Investment Plans consist of 180 investments, ideally made monthly over a 15-year period, although investors may stop and restart investing at any time. The plans have a sales charge equal to half of each of the first 12 investments. When the purchaser has made the equivalent of 180 monthly investments the effective sales charge for the investment period is 3.3 percent. Of course, if investments are stopped and never restarted the effective sales charge percent is higher. For example, if investors stop at 10 years, the sales charge would effectively be 5 percent. Conversely, investors who reach the 180-investment mark may continue to invest without additional sales charge for another 120 investments, which would be another 10 years if investments are made monthly. If the equivalent of 300 monthly investments are made, the effective sales charge is 2 percent.

[12] – EXAMPLE: *A typical 5 percent load on a $300 per month investment generates $15/month or $180/year in potential income for a financial advisor. Many more cost-effective opportunities exist for most advisors where higher-net-worth clients result in a better return forthe time committed.*

For certain classes of plan shares, investors pay a 12b-1 fee ranging from a tenth to a quarter of a percent of assets on an annual basis. Investors enjoy a "withdrawal and replacement" benefit through which they may withdraw a lump sum from their account and replace it later at the current net asset value of the plan without sales charge. Investors are advised that in such instances there can be tax implications and there is market risk as the funds are reinvested at net asset value (NAV).

Effects of the sales charge

Media reports on Systematic Investment Plans tend to focus on the sales charge and its effect on long-term wealth accumulation. Although appropriate disclosures are made concerning the sales charge, the argument is the money not invested in the first 12 months, because of the sales charge, puts the investor at a disadvantage compared to an investor in a no-load or traditional load fund where the sales charge is about 5 percent. The problem with this comparison is that it overlooks the value offered by the systematic plan in creating long-term investors. As stated above, First Command only recommends a Systematic Investment Plan in the context of a broader Family Financial Plan and only for long-term goals. The Family Financial Plan also includes recommendations for insurance and bank-based savings for emergency and short-term needs.

Developing this tailored plan requires that a First Command representative find a prospective client; arrange and conduct an initial appointment; gather and evaluate extensive personal financial details; develop a plan recommendation and have it reviewed by local managers and the First Command home office staff; present the recommendation to the prospective client in a second appointment; implement as directed by the client; and present and explain components of the implemented plan in a third appointment.

At a minimum, the First Command process is designed to provide the client with hours of interaction with our representatives over multiple appointments involving the representatives, their staffs, superiors and the home office support staff. As discussed above, this professional advice offered in one-on-one relationships is, in our view, the best hope for solving the significant problem of personal financial behavior affecting so many American families.[13] In the 2003-2004 sales year, First Command representatives helped clients implement 46,425 financial plans. As of Dec. 31, 2003, First Command clients had a total of 566,000 systematic investment plan accounts placed with mutual fund companies; our average client family is investing $255 a month in those accounts; the accounts had a total net asset value of $9.3 billion; the average net asset value per account was $50,300; and during 2003, $658,733,000 was invested in the accounts. Media discussion of First Command products has centered on the Systematic Investment Plan. However, it is pertinent to note that investment services comprise only about 40 percent of First Command business and systematic plans are only 70 percent of that. Each

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[13] – For a more complete picture of the plan preparation service, see "Sale Charges for Services Associated with Starting Contractual Investments for New Clients," (attached).

Family Financial Plan recommended by First Command includes an insurance and bank-based savings component in addition to a recommendation for long-term pursuit of goals, usually through equity investing.

In a time where we share concerns about the personal financial activities of American families in general and military families in particular, it is important to encourage developing good savings and investment habit.

Congress has taken effective action

The sale of Systematic Investment Plans is governed by the 1970 amendment to the 1940 Investment Company Act.

In the 1960s, these types of plans were different from the systematic plans of today, and there were questionable practices involved. At that time, there were many avenues through which to enter a so-called "contractual" plan. The dollars of contractual investors could be commingled in a mutual fund with non-contractual investors. The front load was collected in a variety of ways, and once committed, consumers had little recourse if they changed their minds.

Recognizing the need to bring protection and good practices to the creation and sale of these plans, in 1970 Congress took effective action so that, as a statutory requirement, each investor receives a letter after beginning a Systematic Investment Plan explaining the costs and offering that for 45 days from the date of the letter any client who wants to withdraw will receive the net asset value of all shares owned and a full refund of sales charges.

The statute also requires that a second letter be sent at 15 months after a plan is started if a client has missed three investments. This letter again explains the costs of the plan and offers the client the opportunity to withdraw and receive the net asset value of all shares owned and a refund of sales charges less 15 percent of the total amount invested. Or, a second letter is sent to systematic plan holders if they have missed one or more investments between the 15th and 18th month after starting the plan. It explains the costs and offers the client the opportunity to withdraw and receive the net asset value of all shares owned and a refund of sales charges minus 15 percent of the total amount invested.

Although it is not required, First Command has created its own disclosure form, which clients sign, indicating they understand the costs and risks of systematic plan investing.

Additionally, as noted above in "Possible Ways Ahead," First Command would recommend Congress consider extending the period of protection from 18 months to 36 months and limiting the amount of the sales charge to 9 percent of the money invested.

The Systematic Investment Plans recommended by First Command are exclusively for systematic investors. Other broker dealers can and do bring clients into these plans, but the plans are designed only for investors with long-term objectives committed to the dollar-cost-averaging pattern of investing.

It is, of course, important that systematic plans be recommended only to those with an expectation of steady income and the maturity and life experience to understand the long-term commitment being made.

HELPING MILITARY FAMILIES

Given our 45 years of service to military members and given the size of our client base, particularly those on active duty, I think it is understandable for First Command to ask: What specific complaints from clients resulted in our being before you now? And the answer, as far as I know, is none.

I can think of few in America more deserving of our protection and help than military families. We have addressed the area of protection and recommended action the Defense Department can take. But who will help military families? More than education is needed. More than commercial products and the military's benefit structure are needed. For the many military families who will not or cannot do it themselves, a financial coach is an effective method by which these deserving Americans can pursue their goals.

Everyday, First Command representatives are working with military families. They are available for the military families should questions or concerns arise. They are available for military families when emergencies arise.[14] They are available for military families when life changes require an adjustment to the plan.

The 1970 amendments to the Investment Company Act of 1940 established conditions for the lawful sale of Systematic Investment Plans that have worked well for almost 35 years. If that law is to be changed, may we respectfully suggest it happen in a carefully considered and informed manner that fully protects the thousands of American families who are presently invested in these securities. We see today's hearing as an important first step in this process, and we appreciate the opportunity to appear today before this Subcommittee.

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[14] – To date, 61 First Command clients have lost their lives in Afghanistan or Iraq since the war on terror began. The average age of the deceased was 31 years. Their aggregate insurance coverage increased more than 22 times and their average investment value increased almost 450 percent. The net result is that after being a First Command client for only an average of six years, the survivors of these individuals received in excess of $6 million in insurance and investment proceeds as a result of their association with our company.

FirstCommand
FINANCIAL PLANNING™

Military Bank Comparison

		First Command Bank	Bank 1	Bank 2	Bank 3	Bank 4	Bank 5	Bank 6	Bank 7	Bank 8	Bank 9	Bank 10	Bank 11	Bank 12	Bank 13	Bank 14	Bank 15	Bank 16
Rates																		
	Checking	**0.55**	0.05	0.20	**1.11**	0.50	0.33	0.50	0.10	0.25	**.70**	0.20	0.25	**.70**	0.50	0 15	0 50	0.50
	MM - $10,000	**1.37**	0.25	0 50	**1.92**	1.22	0.88	1 00	0.50	0.50	1 30	0.65	0.78	1.30	1 00	1 31	**1.46**	0.80
	Credit Card - low	**5.5**	8.4	7 00 (v)	16 00		n/a	9.99	n/a	n/a	11.40	n/a	n/a	11.40	9.99	**4.5 (v)**	9 90	8.99
	Credit Card - high	**11.50**	12.4	**8.40 (v)**		n/a	n/a	**9.99**	n/a	n/a	17.40	n/a	n/a	17.40	**9.99**	16 5 (v)	11.90	12.90
	Loan - unsecured	**9.15**	11.00	10 25	18.00	n/a	9.5-18 **	**8.99**	12.00	n/a	8.25-12	13.00	**6.67**	8 25-12	**8.99**	9.75 (v)	12.00	9.99
	Loan - secured by	**6.00**	n/a	n/a	n/a	n/a	n/a	**5.75**	11.11	n/a	n/a	n/a	n/a	n/a	**5.75**	**5.45**	n/a	n/a
	mutual fund						** rate fluctuates based on rank											
Fees																		
	NSF	**20**	30	32	**14**	21	20.89	28	25	24	25	22	28	25	28	25	**20**	25
	Wire	**12**	15	12	**10**	15	17.93	**12**	**5**	15	15	12	15	15	12	12	14	12
	Check charges	**10**	16.75	**7.50**	**6.00**	18.00	11.49	12.25	12 95	12.15	12.75	**8.20**	15-20	12.75	12 25	**free**	10.45	**free**
	Online Bill Pay	**Free**	4.95	5 95	6 00	n/a	4.95	**free**	5.75	4.95	4.95	4.95	5.95	4.95	free	free	4.95	5 00

banks 1-16 are financial institutions currently serving the military market

n/a means product not offered

(v) variable rate

As of 8/25/04

FCB BETTER

MEETS FCB

BEATS FCB

Average Financial Position of Selected New and Existing Clients

First Command's defined market is active duty military families in pay grades E-6 and above. We periodically sample client data to see the financial standing of the average family when they first start a plan with us.

Our most recent sample from early 2004 included more than 1,500 active-duty E-6s, which are mid-ranking non-commissioned officers. On average, those families had $6,000 in savings, $4,000 in investments and $25,000 in debt, for an **average net worth of negative $15,000**.

The picture for young officers was not much different. The same sampling included more than 1,100 O-1s, who are at an entry-level commissioned rank. On the average, those families had $4,900 in savings, $3,300 in investments and $24,000 in debts, for an **average net worth of negative $16,000**.

This data was compared to more senior military families among First Command clients who were updating their financial plans during the same time period.

The sample included more than 300 E-8s, which are higher-ranking non-commissioned officers. On the average, they had been First Command clients for 3.2 years and had $11,000 in savings, $40,000 in investments and $19,000 in debts for an **average net worth of positive $32,000**.

Our sample included nearly 1,200 O-3 families, which are mid-level officers, having their plans updated. These families had been First Command clients for an average of 5.8 years and the average savings for this group was over $12,000, average investments was nearly $45,000 and average debts were just over $22,000, for an **average net worth of positive $35,000**.

The figures above are averages selected from the First Command database at the times indicated. They may not be representative of the experience of other clients and are not indicative of future performance or success.

Sale Charges for Services Associated With Starting Contractual Investments for New Clients

Average contractual monthly plans size per family for June 16, 2003 – June 15, 2004, is $255. This yields an average sales charge of $255X.50X12 or $1530 per family. For starting client families on these investment programs they receive the following services:

- Prior to engaging in the tailored financial planning process prospective clients are provided an orientation to First Command Financial Planning through either an individual briefing/discussion or through a dinner seminar. During this phase both the prospective client and the respective registered representative have the opportunity to determine whether the financial planning process should proceed.
- On average, prospective clients receive seven hours of individualized face-to-face interviews and consultations with a trained, licensed, supervised registered representative. This includes:
  - thorough analysis of current financial condition to include pay, military benefits, previous year's tax liability, debt, monthly financial behavior, equity position, financial reserves to handle emergency situations without resorting to debt or liquidation of investments.
  - analysis of any existing equity or fixed investments to enable subsequent verification of suitability for the client's stated goals
- The registered representative engages the prospective clients in a discovery process to determine their unique goals, the time horizon for those individual goals, risk tolerance and relative comfort with various investment vehicles as appropriate. The objective of this phase of the discussion is to determine the prospective client's detailed vision of financial success as it pertains to their individual situation.
- The registered representative then begins the process of developing an appropriate and affordable plan to facilitate pursuing the stated goals. This process includes reviewing First Command's recommended investment list, applying the structured planning process through our proprietary planning software and electronically forwarding the draft financial plan to the representative's district agent and registered principal for review and interim approval. The draft financial plan if approved by the district agent and registered principal is then forwarded to First Command's corporate level Financial Plans Department where resident principals again review the recommendations against the prospective clients' current financial condition and goals.
- Assuming the proposed plan is again approved, a written financial plan is provided to the registered representative. The registered representative's staff completes all necessary implementation paperwork for the prospective clients in anticipation of plan implementation. Another appointment with the prospective clients is scheduled. The financial plan is thoroughly reviewed and discussed. A prospectus is provided and reviewed with the clients. The prospective clients may reject the plan recommendations without financial cost, or implement the plan either in whole or part.

- Assuming the client never makes another purchase through First Command Financial Planning, these products will continue to be serviced for the client without additional sales charge for the life of the clients. A registered representative will be available to discuss their plan and their goals at no additional charge. The client is typically called periodically for a face-to-face update review of their financial condition, changes to their goals and status of their investments at no additional charge unless they increase their program.
- The client is tracked by First Command during their frequent moves that occur as part of the mobile U.S. military force.
- The client will receive periodic financial planning notifications and magazines and will have on-line access to their accounts through a proprietary web portal.
- The client will have access to toll-free telephone numbers and Internet capability to contact First Command should they be deployed or out of near access.
- Generally speaking, even in cases where clients have only investments through First Command their assigned registered representative will assist them in survivorship issues should a family member die.

At any time during the process prospective clients are encouraged to call (at no charge) with any additional questions they might have.

LAMAR C. SMITH

Chairman, Chief Executive Officer
First Command Financial Planning

A former Air Force combat pilot, Lamar Smith is Chairman of the Board and Chief Executive Officer of First Command Financial Planning, the leading provider of financial plans to U.S. military officers and NCOs.

Lamar combined the best of his military and business experience to guide First Command to its industry-leading position. A Georgia native, Lamar earned his business degree from Georgia State University before entering the U.S. Air Force in 1970. After pilot training, he was assigned to the 1st Special Operations Squadron in Nakhon Phanom, Thailand, and flew 114 combat missions over Southeast Asia in the venerable forerunner to the A-10...the A-1 Skyraider. Primarily flying combat search and rescue missions, Lamar earned decorations including two Silver Stars, six Distinguished Flying Crosses and 11 Air Medals.

After returning from Southeast Asia, Lamar served as an instructor pilot until 1977 when he departed the Air Force for First Command as a field representative. Following a series of rapid promotions through field leadership positions, he was nominated President and Chief Operating Officer in 1985 and assumed Chairman of the Board and CEO duties in 1992.

Helping military families at every financial level to set realistic goals and pursue them, First Command has grown steadily since it started in 1958. Today, with a field force of approximately 1000 agents, backed by more than 1,500 professionally trained field and home office personnel, First Command serves more than 300,000 current and former military families associated with more than 400 military installations throughout the world.

First Command Financial Planning is part of the First Command Financial Group and oversees client investment accounts valued at over $13.5 billion, life insurance totals of over $49.0 billion, and worldwide banking services through its First Command Bank.

Lamar is involved with numerous public, community, and charitable organizations. He serves on the Board of Directors of: Torchmark, Inc., a NYSE company, Search Ministries, Inc., Trinity Valley School, Lifetime Guarantee, Inc., and is Chairman of the Board of H.O.P.E. Farm, Inc., a mentoring program for inner-city boys at risk which he helped to establish 7 years ago.

Married for more than 31 years, he and wife Jan have an 18-year-old daughter.

National Association of
Insurance and Financial Advisors

STATEMENT OF
DAVID F. WOODS, CLU, ChFC

Chief Executive Officer
National Association of Insurance and
Financial Advisors

And

President
Life and Health Insurance Foundation
For Education

Before the

House Financial Services Subcommittee on Capital Markets, Insurance and
Government Sponsored Enterprises

Regarding:

G.I. Finances: Protecting Those Who Protect Us

September 9, 2004

Good morning, Chairman Baker, Ranking Member Kanjorski and Members of the Financial Services Subcommittee on Capital Markets, Insurance and Government Sponsored Enterprises. Thank you for the opportunity to appear before you today to discuss the financial security of the members of our Armed Forces and their families.

My name is David Woods. I am the Chief Executive Officer of the National Association of Insurance and Financial Advisors (NAIFA) and President of the Life and Health Insurance Foundation for Education ("LIFE").

NAIFA is a federation of approximately 800 state and local associations representing over 225,000 life and health insurance agents and advisors and their employees. Originally founded in 1890 as the National Association of Life Underwriters, NAIFA is the nation's oldest and largest trade association of life and health insurance agents and financial services professionals.

NAIFA's mission is to improve the business environment, enhance agents' professional skills and promote the ethical conduct of agents and financial advisors (whether or not they are NAIFA members). The mission of agents and financial advisors, in turn, is to assist individuals – including military personnel – in achieving financial security and independence.

LIFE, a non-profit educational organization founded in 1994 by six life and health insurance agent organizations in the United States, was formed to address the growing need to educate the public about the essential role of life and health insurance in a sound financial plan. LIFE is not a legislative advocacy organization.

NAIFA and LIFE commend you for holding a hearing on this important issue. We have actively worked on this issue for a number of years, and hope that your involvement will speed action toward improved financial education for military men and women, improved enforcement of consumer protections, and improved regulatory supervision of insurance sales to members of the military.

NAIFA and LIFE Condemn Unethical Sales Practices

Recent press accounts alleging improper sales practices by insurance agents doing business with military personnel has understandably raised serious concerns not only in the Armed Forces and, as this hearing indicates, in Congress, but also in the insurance agent community. As our mission statement indicates, NAIFA's "reason for being" is to promote professional, ethical business practices. We believe that the vast majority of life agents who have military personnel as clients provide an important service and adhere to the highest professional and ethical standards in so doing. We condemn, however, agents who engage in deceptive and/or unethical sales practices and have consistently worked to eliminate such practices for the protection of all insurance consumers – including military personnel whether they live on-post or off.

The interests of the Department of Defense (DoD), Congress, NAIFA and LIFE are aligned in the fight to stop deceptive and unfair practices in the sale of insurance products. We want to facilitate the identification and removal of all individuals who engage in improper sales practices, and have been working at both the state and federal levels to make that happen. For example, NAIFA has offered its expertise to the DoD for many years in development and revisions of DoD Directive 1344.7. That regulation governs commercial sales practices on military bases. NAIFA also has been active in supporting legislative proposals that would allow both state insurance commissioners and insurance companies access to the FBI's criminal history database to improve and expedite criminal background checks of all agents and applicants. In addition, we have recommended that DoD have access to that database.

NAIFA and LIFE Support the Right of Military Personnel to Provide for the Financial Security of their Families

While we must be steadfast in guarding against unethical – and possibly illegal – sales practices, we believe the importance of ensuring that military men and women have access to insurance products cannot be overstated. "Life insurance is not for the people who die, it's for

the people who live." This is the essential reason that education about life insurance – and meaningful access to life insurance products – is so important for members of our Armed Forces. Our military personnel put themselves in harms way every day. They owe it to themselves and their families to be on sound financial footing. Because a financial plan without life insurance is simply a savings plan that dies when the owner does, it is critical that life insurance be considered in conjunction with the creation of any general financial plan for any service man or woman.

In the present climate of heightened security and continuous threat, the availability and reliability of insurance products is paramount – particularly for military personnel. Servicemembers' Group Life Insurance (SGLI) provides excellent benefits to help protect the families of our nation's military personnel. Individual families have unique needs, however, and some men and women serving in the military may want – or need – the freedom to choose additional or separate insurance and investment products for themselves and their families, particularly if post-military service needs are a factor.

Regulation and Oversight of Insurance Sales on Military Bases is the Responsibility of Both the Department of Defense and the States

The sale of insurance on military bases is governed by both the federal government, through the Department of Defense, and the states, which are the nation's primary regulators of insurance.

Department of Defense Directive 1344.7: DoD Directive 1344.7 (the Directive) governs the time, place and manner in which insurance agents may conduct business on military installations. The regulation creates mechanisms for redressing any violations, giving the installation commander broad discretion to bar individuals from further on-base solicitation for any infraction of the regulation, or any other basis provided it is in the best interest of the command. The Directive provides a framework to achieve the goal shared by NAIFA and the Department of Defense to protect military personnel without needlessly excluding reputable insurance companies and insurance agents from offering their services on military bases .

While the installation commander has extensive authority to determine the time, place and manner under which insurance sales can be made, the Directive permits the service men and women themselves to rightly retain ultimate authority to decide whether to purchase insurance products. In addition, the regulation grants all insurance providers equal access to on-base military personnel, provided they comply with all applicable laws, and allows agents to represent multiple insurance companies. This preserves competition without compromising the integrity of on-base sales, both of which benefit military personnel.

State Regulation of Insurance: The DoD's restrictions and limitations on insurance companies and agents are limited to on-base solicitation. This allows the DoD to effectively regulate and eliminate deceptive solicitation practices *on military bases*, without encroaching on the authority of the states to comprehensively regulate the business of insurance. Pursuant to the McCarran-Ferguson Act, 15 U.S.C. § 1101, et. seq., primary responsibility for regulation of the business of insurance is vested in the states. Market conduct – including market practices, sales, trade and claims practices, false advertising, and other consumer protections – is heavily regulated by the states, as is financial solvency.

The DoD, the States and the Insurance Sector Must Work Together to Ensure the Protection of Military Men and Women

The current DoD regulation and applicable state rules strike the proper balance between guaranteeing the right of military personnel to have meaningful access to insurance products and financial education, and ensuring ample protection for these insurance consumers from predatory sales practices. The current regulatory structure establishes a workable mechanism for the supervision of insurance agents on and off military bases. The problem, however, is the lack of coordination and communication between the DoD and state insurance regulatory authorities, and the lack of adequate enforcement of existing rules.

NAIFA and LIFE believe DoD and the state insurance commissioners, through the National Association of Insurance Commissioners (NAIC), should work together to develop a

scheme for the improvement of communication regarding complaints and disciplinary actions, coordination of oversight of insurance sales on military bases, and improvement in enforcement of both DoD rules and state laws.

The Burns Bill: NAIFA applauds Rep. Max Burns (R-GA) for his efforts to provide solutions to these communication, coordination and enforcement problems with the introduction of the "Military Personnel Financial Services Protection Act." We enthusiastically support the proposal's embrace of state insurance regulatory authority and the encouragement given to the states to implement standards to protect members of the Armed Forces, whether they are located on- or off-base. The bill supplements the authority of base commanders by clarifying a significant area of uncertainty under current law regarding state insurance regulatory authority in connection with insurance transactions on military installations.

I would like to note one provision of the proposed bill that could be the cause of some concern to the life insurance industry. Section 3 amends section 27 of the Investment Company Act of 1940 (the 1940 Act), essentially prohibiting a specific type of mutual fund investment product. It is NAIFA's understanding that the narrow focus of this provision is not intended to outlaw the sale of variable life insurance and annuities products, which are specifically exempted from the restrictions of section 27 of the 1940 Act. The actual language in the Burns bill could be interpreted more broadly, however, and lead to unintended, and significantly problematic, consequences for the insurance industry and insurance consumers. We look forward to working with Rep. Burns and the Committee to refine the language so that its intent is clear.

NAIFA and LIFE Support Basic Financial Education for Military Men and Women: DoD Directive 1344.7 addresses the general lack of financial education among young military personnel, as well as the need of military commanders to maintain order and discipline. NAIFA and LIFE recognize that the majority of military personnel are young and often have little financial background or formal financial-planning education. This is true not only in the Armed Forces, but in society as a whole. In fact, last year a bill was introduced in the U.S. Senate that recognizes this problem and aims to counteract it directly. Senator Debbie Stabenow's (D-Mich.) introductory statement for S. 1532 included alarming statistics that demonstrate that the

vast majority of young adults have difficulty understanding even basic financial concepts. We support the framework established under the Directive by which military personnel *can and do* receive this critical financial education.

NAIFA and LIFE believe that allowing insurance agents and advisors access to military personnel improves the fundamental financial education of young military personnel and is a practice that should be continued. The insurance industry is adept at transmitting a foundation of basic financial knowledge to military personnel and other young people. At the same time, LIFE provides crucial risk-based financial planning information directly to a broad spectrum of society, including students. In fact, LIFE already provides educational programs and materials to 25 percent of high school juniors and seniors throughout the country. The LIFE Foundation has offered to provide educational programs and materials it has already developed to the DoD for financial education for service men and women.

NAIFA/ACLI Best Practices: Passage of the Burns bill and improved financial education for military personnel would clarify current laws and regulations, and make their balanced approach to oversight of insurance sales on military bases more effective. With these same goals in mind, NAIFA and the American Council of Life Insurers (ACLI) developed a set of best practices for military insurance sales and their functional regulation. The "Best Practices for Military Insurance Sales and Their Functional Regulation," a copy of which is attached, recommend changes for both regulators and industry and will lead to improved protections for military men and women.

Generally, the best practices address:

> (i) functional regulation, suggesting how the DoD and the state insurance regulators should work together to make regulation of insurance sales on military bases as seamless as possible; NAIFA believes that a critical first step in this process is to put a mechanism in place requiring base commanders to report complaints and disciplinary actions to a central DoD database, the relevant state regulators, and any applicable insurance companies;

(ii) financial literacy, calling for education of insurers and agents regarding the unique aspects of selling insurance to military personnel on military installations, ensuring that education programs are separate from selling opportunities, and encouraging the DoD to provide basic financial education to service men and women, possibly utilizing the resources of the LIFE Foundation, which has offered to provide educational programs and materials to DoD for financial educational programs; and

(iii) military base market conduct, including credentialing and identification of insurers and agents, emphasis on the "free look" after a policy is purchased, discouraging high pressure selling by, for example, designating specific areas for meetings between agents and military personnel, and encouraging insurance companies and agents to seek objective evaluation of the product and the sales process.

Our hope is that the development of these best practices – and their adoption by the DoD, the state insurance regulators, and the insurance private sector – will lead to improved cooperation and communication among the DoD, base commanders, and the state insurance regulators. Better enforcement of current laws and regulations and increased compliance with current laws and regulations will ultimately result in a system in which military personnel enjoy the full protections of insurance supervision and regulation, and ensure they will not fall victim to unscrupulous sales tactics.

Thank you for the opportunity to speak to you today and for your consideration of our views. NAIFA and LIFE have a strong interest in the protection of military personnel from unethical and illegal sales practices. We look forward to working with you to improve the knowledge level of young service men and women about risk-based insurance products like life insurance and to eliminate improper sales practices on military bases. We believe the NAIFA/ACLI statement of best practices are an important step in that process.

# # #

Attachment
Testimony of David Woods
NAIFA/LIFE

The American Council of Life Insurers
The National Association of Insurance and Financial Advisors

Best Practices for Military Insurance Sales & Their Functional Regulation

Military Installation Market Conduct

The Defense Department should consult with the Insurance Marketplace Standards Association (IMSA) for guidance on the ethical standards of insurers and their insurance producers. IMSA was established to help address public concerns about insurer market conduct and has established insurer assessment programs contributing to improved insurer operations and marketplace practices. IMSA maintains appropriate independence from other insurance trade associations to assure confidence in its mission. IMSA likely has programs and standards immediately useful to the Defense Department as a first check of the integrity of an insurer seeking access to military installations. IMSA membership or insurer completion of an IMSA assessment could serve as a credential offering a *prima facie* degree of confidence and "fast pass" access, even while not constituting a requirement for access, to military personnel. A company not willing to become an IMSA member or submit to assessment would not be barred from access but might simply not enjoy the presumption of competence attributable to IMSA qualification, thereby warranting more particular review prior to gaining access privileges.

Each military installation should have locations designated for investment or insurance sales interviews. Disturbing reports of high pressure selling in dormitories and barracks might be addressed by the designation of locations appropriate for meetings between financial service advisors and potential or existing military clientele. The installation commander would likely be the best positioned for such determinations.

Every financial advisor or insurance producer should establish his or her identity as such via a business card given to each serviceman or woman contacted. It takes just a business card with the financial advisor's name, company, address, phone number and/or email contact, and state of insurance license to assure a serviceman or woman that he (or she) knows with whom he (or she) spoke about an insurance product, how to find the advisor or agent again, or how to identify to supervisors an individual trying to sell "out of bounds". The certainty of agent's identification also permits authorities to screen the individual, e.g., against the NIPR Producer Database.

Emphasize the insurance "Free Look" benefit. Insurance policies provide a distinctive benefit to consumers, an opportunity to exercise "buyer's remorse" and cancel a contract days after one receives the finalized policy. The time period ranges from 10 to 30 days, depending upon state law. It is a perfect time to review the policy and evaluate any change in terms, conditions and rates. Military service personnel purchasing an insurance policy should acknowledge at the time of sale that they understand they will have the

advantage of the Free Look period, as well as the opportunity to consult with an advisor other than the insurance agent during that time.

Insurers and producers should offer the opportunity for post sale evaluation of product and sales process. Life insurers routinely survey newly insured individuals about their understanding of the product they have purchased, the reason for doing so, and their evaluation of the sales process. Insurers and producers seeking to sell life insurance to military personnel on post might create a survey form for specific use on military installations. In addition to insurers and producers, survey results should be shared with state insurance regulators and appropriate military installation personnel.

Financial Literacy

The Defense Department should be encouraged to provide basic financial literacy programs for junior enlisted personnel. Such programs might provide, e.g., one hour per financial sector of basic introductory information to the differences between banking, securities and insurance products and services, and be provided by a credentialed instructor from a standard educational program. ACLI and NAIFA recommend the Life and Health Insurance Foundation for Education (LIFE) as a source of a basic educational program immediately available and capable of providing fundamental education about life insurance products and services. LIFE has offered to work with the Defense Department to provide basic education on life insurance use and products. LIFE already provides such educational material to 25% of high school juniors and seniors around the country. The investment and banking sectors may also have educational programs that might be easily obtained for Defense Department utilization.

Financial advisors and insurance agents aspiring to sell products on military installations might be expected to be familiar with military sales rules and installation access protocol. Every state requires insurance agents to pass educational requirements in order to obtain a license. Some states require pre-licensing education and most states require continuing education of their insurance agents. Indeed, insurance producers are among the most educated and regulated sales individuals of all American industries. Yet an insurance producer or investment advisor might not have reliable guidance with regard to military installation access protocol or Defense Department rules for selling financial services to our troops.

Defense Department financial service educational programs might be separated from selling opportunity. If GAO investigators confirm that events billed as opportunities for financial services education have been misused to coerce product sales, consideration might be given to separating educational from sales opportunities by time or space.

Functional Regulation

Centralize insurance supervisory activities within the Defense Department. Every complaint about an insurance producer or insurer communicated to a state authority or resulting in a military installation sanction might be communicated to an individual or office within the Defense Department who can coordinate disciplinary activity with all regulators and all military installations. This office, over time, will be able to develop oversight of patterns or practices that might be further evaluated for propriety and addressed effectively by military directive. Centralized Defense Department supervision might provide liaison between every installation commander and state insurance commissioners, as well as field insurance inquiries and complaints arising from insurance sales activities whether they occur on or off the military installation.

Resources might be authorized for the Defense Department to subscribe to the National Insurance Producer Registry (NIPR). The NIPR is a subsidiary of the National Association of Insurance Commissioners (NAIC) that maintains a Producer Database of about four million (4,000,000) licensed insurance producers in the United States. The Defense Department can obtain instant access to every insurance producer in the country, including whether a producer's license has been suspended or revoked in any state, by subscribing to the NIPR.

Defense Department Directive 1344 regarding Personal Commercial Solicitations should be synchronized with established financial services functional regulation. The persistence of financial service problems on military installations suggests that relevant Defense regulations might obtain value added by the regulators with expertise in the different financial service sectors. Revisions to Directive 1344 should be vetted with the functional financial service regulators. Coordination between Defense Department financial services supervisors and financial service functional regulators could successfully leverage regulatory strengths.

State insurance regulation applies to military installations. Just as federal banking regulations are applicable to depository institutions located on military bases so, too, are state insurance regulations applicable to producers and companies engaged in the business of insurance on military installations or selling to active military personnel.

~*~

Horizon Life
. . . a balanced plan of
protection and accumulation.
Current Interest Rate
6.5%
4%
Guaranteed Interest Rate

Horizon Life

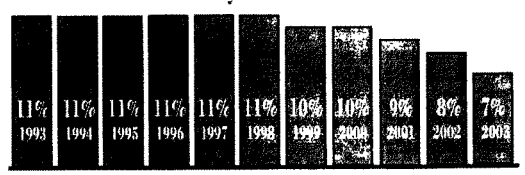
The Horizon Life is a combination of a Seven Pay 20 Year Level Term Life Insurance policy (Form No. [illegible]) and an Annuity Accumulation Fund Rider (Form No. 3831), which we call the Horizon Life Fund (HLF). The program includes a death benefit should something happen to you during the first 20 years, while accumulating cash in the Annuity Accumulation Fund Rider.

A FINANCIAL SUCCESS FORMULA

Time + Money + Interest = Opportunity for Financial Success

You provide the time, you provide the money, your HLF provides the competitive interest rate to complete the formula for your financial success!

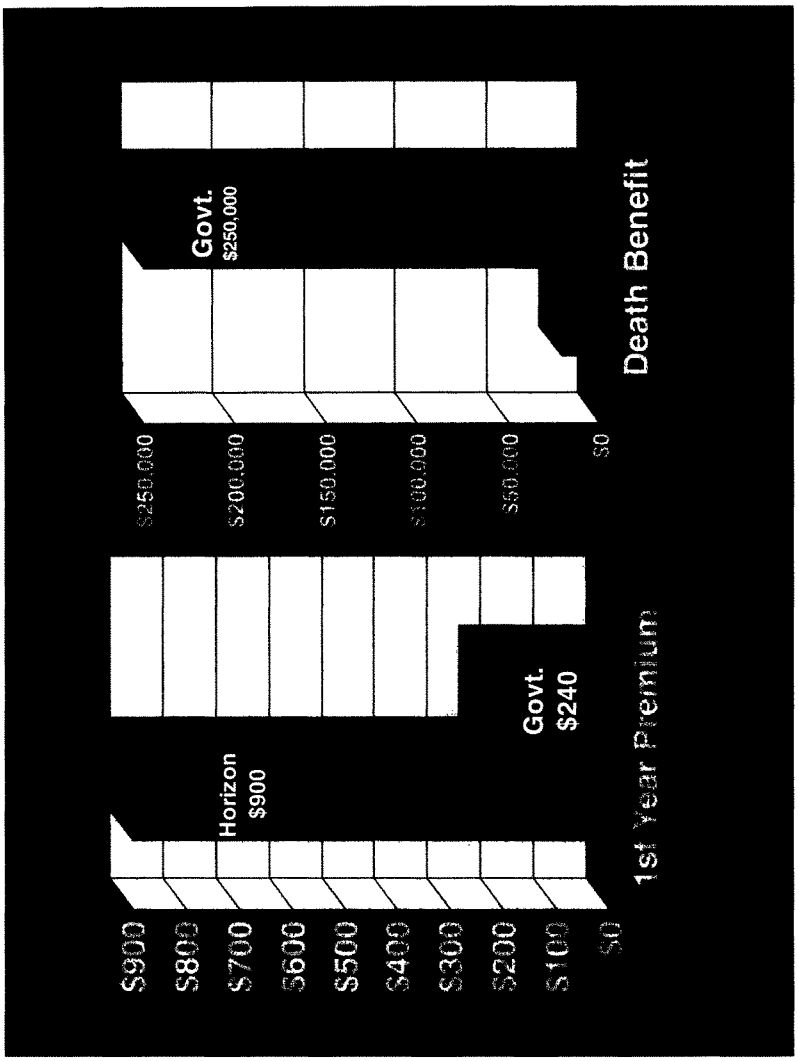
The Company's Annuity Accumulation Fund Rider History of Interest Rates



The AAFR has averaged over 10% since its inception.
The company has had an accumulation fund attached to its life insurance plans since 1963!

GI Joe / GI Jane

- Median Age = 24
- Total Compensation = $30,921.13
  (as of 9/2003)
- Rank = E3 (Private First Class)
- Average Service Time = 7 years


$900
$800
$700
$600
$500
$400
$300
$200
$100
$0
Horizon
$900
Govt.
$240
1st Year Premium
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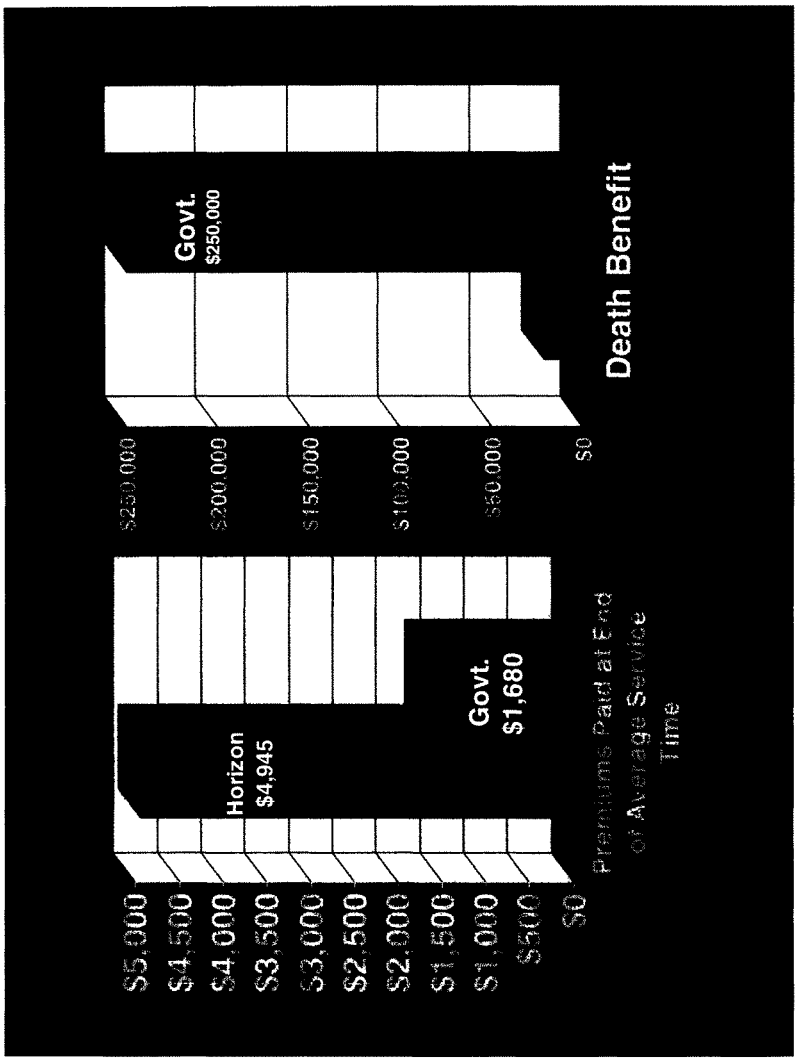
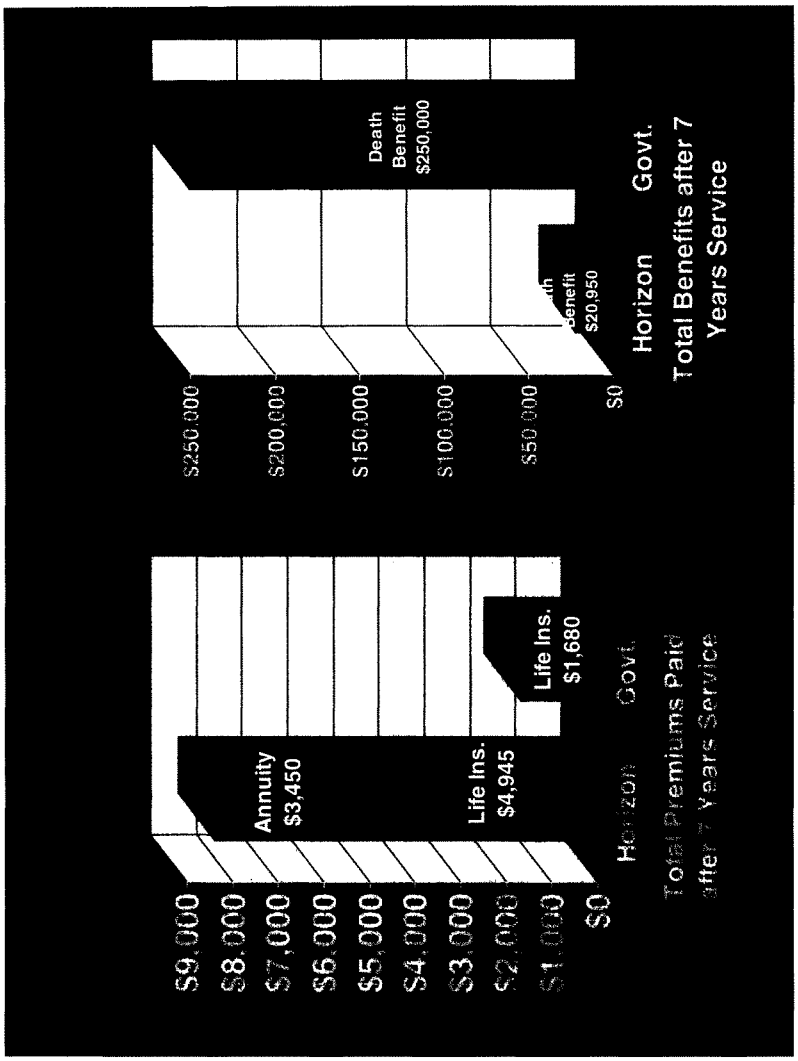
$200,000
$150,000
$100,000
$50,000
$0
Govt.
$250,000
Death Benefit


$5,000
$4,500
$4,000
$3,500
$3,000
$2,500
$2,000
$1,500
$1,000
$500
$0
Horizon
$4,945
Govt.
$1,680
Premiums Paid at End
of Average Service
Time
$250,000
$200,000
$150,000
$100,000
$50,000
$0
Govt.
$250,000
Death Benefit


$9,000
$8,000
$7,000
$6,000
$5,000
$4,000
$3,000
$2,000
$1,000
$0
Annuity
$3,450
Life Ins.
$4,945
Life Ins.
$1,680
Horizon
Govt.
Total Premiums Paid
after 7 Years Service
$250,000
$200,000
$150,000
$100,000
$50,000
$0
Death
Benefit
$250,000
Benefit
$20,950
Horizon
Govt.
Total Benefits after 7
Years Service

Effective Yield of Horizon Annuity
4.00%
2.00%
0.00%
-2.00%
-4.00%
-6.00%
-8.00%
Year 1
Year 2
Year 3
Year 4
Year 5
Year 6
Year 7

INSURANCE MARKETPLACE
STANDARDS ASSOCIATION

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Committed to honesty,
integrity and ethics

STATEMENT BY BRIAN K. ATCHINSON,
EXECUTIVE DIRECTOR,
INSURANCE MARKETPLACE STANDARDS ASSOCIATION
(IMSA)

SUBMITTED TO THE
HOUSE FINANCIAL SERVICES SUBCOMMITTEE ON CAPITAL MARKETS, INSURANCE AND GOVERNMENT SPONSORED ENTERPRISES

FOR HEARING ENTITLED
"G.I. FINANCES:
PROTECTING THOSE WHO PROTECT US"

SEPTEMBER 9, 2004

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Statement by IMSA Executive Director Brian Atchinson

Mr. Chairman and members of the Capital Markets Subcommittee, on behalf of the Insurance Marketplace Standards Association (IMSA), I want to commend you for holding hearings on the issue of inappropriate and unethical insurance and investment sales to members of our Armed Forces.

As the organization leading the insurance industry in promoting high ethical standards in the marketing of individual life insurance, long-term care insurance and annuity products, IMSA can offer an important perspective on these practices and offer solutions. We believe that all consumers, including those serving in the U.S. military, should receive clear and honest information before they purchase any type of insurance product. They also should be offered products that are designed to meet their insurable needs and financial objectives. Such "needs-based selling" is one of the most fundamental standards for the life insurance industry and a key component of IMSA qualification.

This summer, when we learned of the unethical insurance sales practices on military bases, we wrote to Secretary of Defense Donald Rumsfeld. As you can see from my attached letter, dated August 2nd, we offered to work with DOD officials to establish ethical standards for companies that sell to military personnel.

We believe there are a number of steps DOD should take to put an end to unethical and fraudulent insurance sales on military bases and to prevent future abuses. Last year, we met with DOD officials to discuss ways to establish standards for ethical sales of life insurance on their property. At that meeting, we suggested DOD use IMSA's ethical standards as guidelines for establishing a similar system to protect military personnel. Since IMSA was created as a non-profit organization in 1996, IMSA-qualified companies have established and maintained procedures and internal guidelines that have enabled them to better serve customers and strengthened consumer trust and confidence in the life insurance industry.

To earn the IMSA seal, insurers must pass a rigorous, independent assessment of their sales and marketing practices. Qualified companies must commit to adhere to high ethical standards in the sales, marketing and servicing of individually sold life insurance, long-term care insurance and annuity products and to follow IMSA's Principles of Ethical Market Conduct. Those principles are:

1. To conduct business according to high standards of honesty and fairness and to render that service to its customers which, in the same circumstances, it would apply to or demand for itself
2. To provide competent and customer-focused sales and service
3. To engage in active and fair competition
4. To provide advertising and sales materials that are clear as to purpose and honest and fair as to content
5. To provide for fair and expeditious handling of customer complaints and disputes
6. To maintain a system of supervision and review that is reasonably designed to achieve compliance with these Principles of Ethical Market Conduct

Clearly representatives of those companies cited in media reports for their unethical sales practices – who are not IMSA members, by the way -- are not following principles of ethical market conduct. We encourage the Department of Defense to establish clear and strong ethical requirements in the near future for any company wishing to sell life insurance on military bases and to bar those who do not behave ethically from doing business on government property.

Let me give you one example of the kinds of principles we believe DOD should establish for organizations that want to offer life insurance to military personnel. Customers must be able to understand the products they are purchasing. IMSA standards require our qualified companies to provide advertising that clearly describes the product recommended so consumers can make informed buying decisions.

Strong disclosure standards would help to avoid some of the recent instances of inappropriate sales activities. Also, requiring companies and their representatives to sell to customers based on their needs would have avoided some of the reported problems, because the process places the interests of the consumer at the forefront of the sales process. The first step in needs-based selling is for an agent to work with a customer to determine his or her individual insurable needs or financial objectives. The agent then recommends an insurance product or products that best meet those needs or objectives. For the integrity of the process and to best serve the customer, the agent must be honest and clear about the features and costs of the products.

Consumers, whether in military or civilian roles, need to understand that life insurance policies are legally binding contracts. Buying insurance and other financial service products is complicated, and it's not something to make hasty decisions about before shipping overseas.

We hope your hearings will help bring this message home to consumers and encourage the Department of Defense to take steps to establish safeguards in the insurance arena for our men and women in uniform, just as those men and women safeguard us.

Lt. Wayne V. Hildreth, U.S. Navy (ret)
Statement for the Record
September 8, 2004

Chairman Oxley, Congressman Frank, Congressman Burns and Members of the Committee, I am truly honored to appear before you today, and elated that you are considering measures to protect our troops from financial predators. I do not represent the interests of any corporation, government agency, organization or lobby. I am here today as one small voice arguing for change. A small voice stacked against a powerful industry lobby and an agency bureaucracy incapable of protecting our men and women in uniform from financial harm, and through inaction an agency that remains complicit in allowing certain behaviors to continue that places our service men and women in 'harm's way.' I applaud the Committee's efforts, and in particular, Congressman Burns, in your collective attempt to address a critical problem that has plagued the men and women of our armed forces since the late 1950s through the Bill to Prevent the Sale of Abusive Insurance and Investment Products to Military Personnel.

In 1997 while still on active duty in the U.S. Navy assigned as the Command Judge Advocate at Naval Air Station, Cecil Field I was appointed to conduct an investigation into the business practices of the Noncommissioned Officers Association (NCOA) that began as a result of complaints of questionable practices on the part its Academy Life Insurance agent in the Jacksonville, Florida vicinity. At the time there were four naval military installations in and around Jacksonville. It is through the course and conduct of this investigation that I am invited here today.

I determined in the early days of this investigation that the solicitation problems uncovered occurred at military installations throughout the world and even onboard ships at sea. I realized that members of each branch of the armed forces, and even other federal agencies with member associations were being victimized by unscrupulous business practices from insurance agents from several companies with business relationships with nonprofit associations, and other companies with a profit motive but with an appearance of benevolence through the corporate name and marketing strategy. I learned that outside of an article written in the Army Times in 1973 that no comprehensive effort existed to try to piece together the nature and extent of the insurance solicitation problem onboard military facilities. I understood that previous investigative efforts at military installations were local in nature, fragmented, and that these investigations were not shared within the same service branch much less between the branches. I learned that insurance companies hawking poor products tended to operate from the State that offers least resistance, since insurance regulatory oversight and enforcement is a State matter and there are certainly 50 ways to regulate insurance. I determined that the issue core lie in the special relationships designed and perpetuated by selected nonprofit associations with associative insurance companies and insurance companies that focus in the military niche market with influential members within the Department of Defense and this august body, the U.S. Congress. Solve this issue and you solve the problem.

The investigative report was crafted in such a way to outline the enormity of the problem globally and that extended well beyond the NCOA/Academy Life focus. The investigation was submitted through appropriate channels and forwarded in good faith that the leadership that I held in high regard for 26 years would make the right decisions and protect the interests of those who relied upon them. I retired from the Navy in 1998 very disappointed in the military and political leadership in Washington, DC that held the power to act, but didn't. I recognized quickly that a simple band aid would be applied to the insurance solicitation problem, and the questionable business practices would be modified by the companies in question and essentially allowed to continue at military installations throughout the world. In essence, the Department of Defense has elected to address the issues raised by creating additional investigative bodies, and to study, and study, and study the same issues that the institution had been aware of since the early 1970s when Secretary Laird ordered implementation of DOD solicitation regulations. These investigative efforts, and in particular, the comprehensive investigation conducted by General Cuthbert in May of 2000, whereby he recommended that insurance sales solicitations be banned from U.S. military installations, have led to little action. General Cuthbert certainly substantiated that the insurance and financial product solicitation problems at military bases were widespread and made fine recommendations. Where my view differs from General Cuthbert is that I recommend a total ban of all commercial solicitation from being perpetuated upon U.S. service members at any location of military jurisdiction.

I recognize that this suggestion may appear extreme; however, I am convinced that no other procedural solution is economically viable or even manageable by a Defense infrastructure and military chain of command that responds best by being told what to do in commercial matters where industry regulatory oversight is vague and enforcement varies from state to state. My belief that left to their own devices the Department of Defense is simply uncomfortable or even incapable with effectively dealing with solicitation onboard military installations consistently across the board.

U.S. Government Standards of Ethical Conduct do not allow for providing preferential treatment toward any one person or entity above another. When one insurance, financial service or other types of business interested in selling to service members is permitted on base, the installation commander must theoretically allow them all onboard or face industry backlash or pressure from above. I submit that the military is not equipped to properly regulate these types of sales. Moreover, I strongly believe that the special relationships developed here in Washington, DC between a few disingenuous insurance and financial service companies that are associated with a military type associations or whose business focus is with the military niche market represent the problem. Please do not read this as an indictment of all military associations. Although most nonprofit organizations have insurance products tied to their name, there remain many fine military associations with true benevolent purpose who elect to market insurance products through non-intrusive means and without going on base.

I believe the proposed legislation to be a good beginning; it attacks the abuse of the military pay allotment system. The language in the Bill placing the onus on the States to devise action to protect military personnel from financial predators is well intentioned. However, most military installations are not exclusively federal in jurisdiction but rather concurrent. Hence, most States already possess jurisdictional authority to regulate insurance. Should the individual States create standards to protect service members I view it as difficult for all 50 states to unify procedures and enforcement which I consider to be an essential element for success should Congress take this approach. Given that each state offers its own brand of insurance regulations, that state insurance commissioners tend to be under-funded, and that state legislatures are often comprised with many elected officials from the insurance industry and therefore establishing consistent application and protection appears impossible. All of this is exacerbated when state agencies try to coordinate with a federal agency that maintains a global presence and its constituents frequently move and are often not citizens of that particular state.

Establishing and maintaining effective and consistent lines of communication and reporting between the military and the States will also be difficult, as this represents the essential ingredient toward success. However, how do you stop a rogue insurance company from dissolving corporate operations in one state and establishing operations using a dormant insurance corporation in another state? This scenario follows how the so called 'bad' insurance agent that plague military installations move from area to area when the heat is turned up, but on a corporate scale.

May I recommend that this Committee work jointly with the House Armed Forces Committee in seeking resolution to the solicitation problems at issue. Working together and in conjunction with the Department of Defense, a viable solution may be found. I still hold that banning commercial sales directly to military personnel on base is the only true answer. The task before this Committee is enormous if eradicating the negative behavior of those few insurance and financial service companies is to be achieved. I do thank you for taking the leadership to finally work to resolve this longstanding problem. I only ask you not to study this to death. Please act!

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