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Metropolitan Management Leaders' Conference (1)

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SPEECH BY SENATOR MAX BAUCUS

METROPOLITAN MANAGEMENT LEADERS' CONFERENCE

February 1, 1988

Introduction

Thank you, Vince. And thank you John and Richard and Metropolitan Life for inviting me here today. It's good to see you again, John.

I notice that last year Met Life increased its contributions to surplus from $2.8 billion to $3 billion. That's a 7 percent increase.

Now, the federal government spends about $1 trillion per year. If we cut spending by 7 percent, we'd reduce the deficit by $70 billion.

If we raised revenue by 7 percent, we'd reduce the deficit by another $60 billion, for a total cut in the deficit of $130 billion.

So the way I figure it, if we put you guys in charge of the government, the federal deficit would disappear.

As you know, I am Chairman of the Taxation subcommittee in the Senate, and I'm here to talk about how the 1988 tax agenda might affect your industry.

I recently asked a Montana agent what he thought about all the recent tax legislation. "Well," he said, "It's like attending a Sylvester Stallone film festival. You don't think it can get any worse. But it does."

The Flood of Tax Legislation

While I don't entirely agree with his asessment, I understand his frustration. During the eighties, the life insurance industry has faced a flood of tax legislation.

In 1982, Congress limited the use of modified coinsurance, limited the use of flexible premium contracts, and adopted temporary provisions designed to maintain segment balance. Nineteen pages of fine print.

In 1984, we rewrote the life insurance tax rules from top-to-bottom. Sixty pages of fine print.

In 1986, we changed the rules for installment sales, and structured settlements. We overhauled the pension rules. And we imposed a complex new minimum tax. Thirty-four pages of fine print.

And in 1987, the Congress changed the rules for computing tax reserves and book income. That was a slow year. Only six pages of fine print.

That's over 100 pages of new life insurance tax law in 5 years.

Why?

First of all, insurance is a dynamic industry. Competition is fierce. Products keep changing.

And the tax laws have to keep pace. The life insurance tax law of 1959 simply didn't match the life insurance industry of the early 1980s. It needed an overhaul.

The second reason is fairness within the industry. The development of products with special tax advantages, like modified coinsurance, gave some companies a competitive tax advantage over others. Congress has generally tried to adjust the law to maintain a competitive balance.

The third reason is revenue. The federal debt is growing at the rate of $17 million dollars an hour. It is a major cause of our trade deficit and our ticking debt bomb which, if not defused, will soon destroy the standard of living we are accostomed to.

The federal deficit simply must be reduced. Spending must be cut. All spending, including entitlement spending.

I, for example, have been pushing an across-the-board spending freeze that would apply to <u>all</u>

categories of federal spending, including defense and entitlements. Unfortunately, only 24 of my colleagues agreed to support the freeze last year.

We also have to raise revenue. Everybody knows this. But nobody wants to say it, including the Presidential candidates. Only Bruce Babbit has dared to say that the Eperor has no clothes.

Yet this is not some deadly policy that will drag the country down, taking you and me with it. If you compare the level of taxation in the U.S. and other industrialized countries, we're way below average.

For example, in West Germany the overall level of taxation is 22 percent higher than in the U.S. However, Germany has been increasing productivity almost twice as fast the U.S.

We're not over-taxed. We're over-borrowed.

In the meantime, the Congress has been nickeling and diming, searching every nook and cranny, looking for ways to squeeze out a little more revenue without raising tax rates. This has affected many industries, including yours.

I expect this coming year to be no different. As the Congress wrestles with more spending cuts and with efforts to make our country more competitive, it will be another busy year for the Congressional tax committees.

Single-Premium Life

What does this mean for the life insurance industry?

It does *not* mean that basic life insurance incentives are in jeopardy.

The tax exclusion of death benefits and inside buildup are definitely not perceived to be loopholes.

That's because they don't benefit special interests. They instead promote the *public* interest. They encourage people to buy life insurance as a way of protecting their families. That's just as important today as it was when the Presbyterian Church established the first U.S. life insurance company in 1759.

If the tax exclusion encourages more people to buy life insurance, that benefits us all.

But there's a flip side.

Congress provides tax incentives in order to promote life insurance, even where conventional life insurance policies have a significant investment component. That's fine.

But if tax incentives are used to promote products that are predominantly investments, with a relatively small life insurance component, it's a different story.

In that case, the tax incentives don't benefit any important public interest. Instead, they favor one investment over others. They favor investment through a life insurance at the expense of investment through a mutual fund or CD.

That tax differential drains away federal revenue, as more and more people figure out ingenious ways to shelter income. And, it's not fair to other investment industries.

There's also another important side effect.

The proliferation of life insurance products that are predominantly investments undermines the industry's credibility in Congress.

If the distinction between life insurance products and investment products becomes blurred, life insurance run the risk of losing its special appeal. The public policy justification for tax incentives will erode.

In light of this, the industry and its Congressional supporters have a common interest. The border between life insurance products and investment products must be well-patrolled.

Well, you might ask, where does single-premium life fit into all of this?

The old saying goes that if it looks like a duck, quacks like a duck, and waddles like a duck, it probably is a duck.

Well, single premium life looks like it's predominantly an investment.

Recent newspaper ads certainly look that way. Like the one in the Wall Street Journal touting single premium policies as "Better than a CD, Treasury Bill, Money Market Fund, Zero Coupon Bond, Annuity or Municipal Bond."

What's more, 52% of all single premium policies are sold by stockbrokers rather than life insurance agents.

And the average premium of $31,000 provides average death benefits of only $81,000.

Tax incentives designed to encourage life insurance are being used to encourage a particular form of investment.

But, as you all know, it's a lot easier to describe a problem than it is to solve it.

It will be my hope that Congress not over-react by throwing the baby out with the bathwater. Single premium life is a narrow problem. We need a narrow solution. A scalpel. Not a meat axe.

Congressman Stark of California has introduced a bill that would treat all single premium and periodic premium policyholder loans as ordinary distributions. The amount representing inside buildup would be taxed.

I have a lot of respect for Pete Stark. He has become an expert on life insurance industry taxation. And I share his concern about single premium policies.

But in my view his bill is not a scalpel. It's a meat axe. It goes too far.

Sure, it would curtail the use of single premium life policies. But it would also eliminate the sound, customary, traditional use of policyholder loans on ordinary whole life policies.

A narrower approach would be to treat distributions as ordinary income, but only for policies that are predominantly investment-oriented.

Others suggest that the definition of life insurance policies be changed to require the policyholder to buy more insurance for each premium dollar.

And there may be other ideas.

But whatever the solution, it should not apply retroactively to existing policies. That would be patently unfair.

As Chairman of the Taxation Subcommittee, I plan to review all of these suggestions. I look forward to working with Metropolitan and other companies to find a responsible solution.

Segment Balance and The Treasury Study

There's another life insurance taxation issue that may come up this year--the battle between stocks and mutuals over "segment balance."

This has become the political version of the feud between the Hatfields and the McCoys.

It's been going on for years.

Anytime one side hears something rustling in the bushes, the other starts blasting away.

Even so, we achieved a temporary cease fire in 1984, but it wasn't easy.

We had to enact a complex package that contained two features unique to tax law.

First of all, in 1984 Congress took the unprecedented step of establising a $3.1 billion revenue target for the life insurance industry. We don't do that for banks, or steel companies, or any other industry. But, in this case, it was necessary to agree on a target before we worked out the details.

Second, both sides wanted to be sure that the other paid its fair share. So the concept of "segment balance" was born. Of that $3.1 billion, mutual companies would pay 55% and stock companies 45%. This would be accomplished through a Rube-Goldberg device called "section 809."

In the last two years many are now wondering whether segment balance makes sense. How should it be measured? How should the mutual company share be allocated?

Within the next few months, we may have an opportunity to review these questions in some detail when the Treasury Department releases an interim study on the operation of the 1984 provisions. The study should tell us whether we are meeting our revenue and segment balance targets.

Congress will, of course, be concerned about revenue. If the $3.1 billion target is not being met, we'll want to know why.

But we'll be concerned about fairness, too. Despite our reluctance to reopen the massive 1984 compromise, we have an obligation to see how the concept of segment balance is working.

I can't tell you what the right segment balance percentages are. As far as I'm concerned, it's like slicing a shadow.

But I would like to ask you whether this long inter-industry struggle is worth it.

The life insurance industry faces many challenges.

You must develop new products that serve a changing society and an aging population.

You face increased competition from other financial services.

And you're fighting countless battles in Congress and in state legislatures.

In the face of these challenges, I suggest that you simply can't afford to continue this war of attrition with your industry brethren.

It diverts your attention.

It exhausts your resources.

It reduces your influence.

And, frankly, it makes you an easy mark when Congress is looking for ways to raise revenue.

My advice is simple. The more you can cooperate, the better off you'll be.

In fact, we must all work better together because today we face an unprecedented economic challenge. From Japan. From Europe. From newly developing nations. Their productivity is increasing faster than ours. In Japan, <u>three times</u> as fast.

In key basic industries such as the auto industry, the U.S. has slipped from half of the world market share two decades ago less than a quarter today.

In business services --- and remember all the ballyhoo about the U.S. becoming a service economy? --- our position has dropped from 15 percent of the world market share in the early 1970's to only 7 percent today.

We no longer enjoy massive surpluses in agricultural trade. Over 80 percent of my home state's economy --- Montana --- is based on natural resources, of which agriculture is a major part. We are fighting for market share all over the globe.

Two decades ago less than 25 percent of American industry faced foreign competition. Today 70 percent do.

And one of the most disturbing signs, in my mind, is the fact that in high tech trade --- the crown jewel of our economy --- the U.S. has gone from a trade surplus of $28 billion in 1981 to a trade deficit today.

We are being pushed back across the board.

As a result, the American standard of living is stagnant. For the average family, it's the same today as it was in 1970.

Think about it. What's the American Dream? To provide our kids with a better way of life than we had. You probably understand that better than anyone. It's what life insurance is all about. You're the link between generations, with each generation providing for the next.

But now, for the first time in memory, it's harder for many Americans to buy a house or send their kids to college than it was for their folks.

We've got to turn that around.

We've got to work together.

We've got to compete.

I helped found the Congressional Caucus on Competitiveness. The Caucus, along with a sister organization -- the Congressional Economic Leadership Institute -- have made competitiveness more than another Washington buzzword.

Each of us is focusing on different areas of expertise -- education, management,energy, and in my case tax and trade policy -- asking whether it hurts or helps our competitive position at home and abroad.

Because, frankly, we will never again just compete at home. Ever.

Decisions made in Tokyo, Bonn, Seoul have as much influence on our lives as do those made in Washington, New York and Los Angeles.

You understand that.

In this vein, I want to commend the Met for its work to expand operations into Asia. That's exactly the kind of aggressive market expansion that we need.

And by the way, if you guys can help me sell more Montana beef to Japan, I would really appreciate it.

In closing, however, let me say that all the words and figures cannot replace what is in this room --- people. Your success and the success of Met Life is a result of hard work. Putting your shoulder to the grindstone.

America has traditionally led the pack. But that won't continue automatically. In the financial services sector just as much as in steel manufacturing or high-tech, we've got our work cut out for us.

I for one look forward to the challenge, especially if we have the opportunity to meet it together.

Thank you.