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Proposed Rule 151A Proposes Sweeping Change

BY GARY COHEN, CHIP LUNDE & RICHARD CHOI

After a three-year collaboration with the North American Securities Administrators Association, on June 25, 2008, the SEC proposed a new Rule 151A that would require registration under the Securities Act of 1933 for the offering of certain types of fixed index annuities.

Proposed Rule 151A would set out a new definition of “annuity contract” under the exclusion in Securities Act Section 3(a)(8). If adopted, it would prospectively define certain fixed index annuities as not being an “annuity contract” or “optional annuity contract,” even though regulated as annuities under state insurance law if the amounts payable by the insurer under the contract are: (i) calculated in whole or in part by reference to the performance of a security, including a group or index of securities; and (ii) more likely than not to exceed the amounts guaranteed under the contract. Proposed Rule 151A would apply prospectively, and not to fixed index annuities issued before the effective date of a final rule if adopted.

The SEC received hundreds of comment letters by the September 10 deadline, which was not extended despite countless requests. Most commenters, including NAFA and NAIC, oppose Proposed Rule 151A. Others, including NASAA and the Investment Company Institute, support the rule. Some insurers, including AXA Equitable and The Hartford, expressed support for further regulation of index annuities, but expressed concern about the rule’s breadth. In opposition to the proposed rule, NAFA argued that the SEC did not provide sufficient evidence of selling abuses or lack of enforcement to justify the proposal. NAFA argued that fixed index annuities are not securities under three different Supreme Court standards: (a) *VALIC* and *United Benefit*, because the owner does not assume substantial investment risk where the insurer guarantees principal, a minimum interest rate and credited interest; (b) *Howey*, because any risks assumed by the owner relate to fluctuations of an external index and, not the managerial efforts of others; and (c) *Weaver*, because the owner is protected by state insurance regulation. The NAFA letter detailed existing regulation of fixed index annuities under state insurance law.

The NAIC, also in opposition, emphasized that state insurance laws regulate not only insurance company solvency, but also advertising, replacement sales, producer licensing, and continuing education. The NAIC also highlighted a new model regulation to address certain sales practices, disclosure and suitability requirements.

NASAA argued that fixed index annuities are securities under the tests referred to above. Stay tuned.