



MIXED RESULTS IN RULE 151A OPINION

Court Finds SEC Meets **Chevron** Test in its Analysis of "Annuity Contract" Under 3(a)(8), But Concludes Rule Adoption Was "Arbitrary and Capricious" and Remands For Reconsideration

The U.S. Court of Appeals for the D.C. Circuit has ruled on lawsuits brought against the SEC to vacate Rule 151A. A copy of the decision in *American Equity Investment Life Insurance Company, et al. v. SEC* is available [here](#). The Petitioners in this case argued that the Rule should be overturned for two reasons: (1) it promulgated an unreasonable interpretation of the term "annuity contract"; and (2) the SEC's action was arbitrary and capricious because the SEC failed in its obligation to consider the effect of the Rule on efficiency, competition and capital formation. Jordan Burt submitted an amicus brief on behalf of a client in support of the Petitioners' challenge.

This client alert provides a brief summary of the decision - we will be furnishing a more detailed analysis with our observations on future impact shortly.

(1) ***Interpretation of the Term "Annuity"***

The Appeals Court applied the two-part test under *Chevron* for review of agency rule-making. It first found that the statutory term "annuity" was not unambiguous and therefore the SEC had the power to regulate as to its meaning. In addressing the second prong, whether the SEC's interpretation is "reasonable," the Court noted that "it is irrelevant that this court might have reached a different - or better -- conclusion than the SEC" so long as the SEC's action is deemed to be "reasonable." It then reviewed the applicable case law as described below and concluded that the SEC's interpretation of "annuity contract" under Section 3(a)(8) of the Securities Act met that test.

Regarding Section 3(a)(8), the Appeals Court discussed the Supreme Court's approach taken in the *VALIC* and *United Benefit* decisions and concluded that, although an "FIA is akin to an annuity," it is "decidedly more like a security" because the index-based return is not known until the end of a crediting cycle. This approach to the test of a security, and in particular, the Appeals Court's discussion of investment risk-shifting does not appear to line up with the *VALIC* and *United Benefit* precedents. Moreover, the failure of the Appeals Court to even consider the implications of the Supreme Court's more recent decisions (as encouraged by SEC briefs in those cases) regarding the application of adequate state regulation in determining whether a financial

product is a security for purposes of regulation under the federal securities laws (see *Marine Bank* and *Reves*) is at least questionable. However, as noted below, the Appeals Court may have concluded that its remand based on the SEC's failure to consider and analyze existing state regulation in its decision to adopt the Rule has reserved this issue for a later date.

(2) ***Arbitrary and Capricious Failure to Consider Impact of the Rule***

As to the second basis for review of Rule 151A, the Appeals Court reached an entirely different conclusion regarding the SEC's actions. The Appeals Court concluded that the Rule should be remanded back to the SEC for further action, because the SEC's conduct was "arbitrary and capricious" in not properly considering the effect of the Rule on efficiency, competition and capital formation, as required by Section 2(b) of the Securities Act. Regarding the remand, the Appeals Court, among other things, called for the SEC to consider the Rule's effect on competition and to review existing state law.

This is a formidable and time-consuming task, with no assurance that the Appeals Court will find that the SEC's work meets the statutory standard. The task, among other things, may require the SEC to subject its review to still another round of public comment. Whether (and when) the SEC will choose to assume these tasks, in view of the current pressures on the SEC regarding proposed financial regulatory reform, is quite uncertain.

To our knowledge, the Petitioners have not signaled their intentions at this point, although we note that they could seek rehearing in the DC Circuit or pursue a writ of certiorari to the Supreme Court. Moreover, legislation is pending in both the House and the Senate that would vacate Rule 151A. Reports are that the bills are attracting additional co-sponsors.

In any event, the SEC may find it necessary to defer the compliance date of the Rule until sometime after the current date of January 12, 2011.

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