

No. 09-1021 (consolidated with No. 09-1056)

UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT

AMERICAN EQUITY INVESTMENT LIFE INSURANCE COMPANY, *et al.*,

Petitioners,

v.

SECURITIES AND EXCHANGE COMMISSION,

Respondent.

On Petition for Review of an Order
of the Securities and Exchange Commission

OM FINANCIAL LIFE INSURANCE COMPANY'S SUPPLEMENTAL BRIEF
IN SUPPORT OF ITS PETITION FOR PANEL REHEARING

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PRELIMINARY STATEMENT

On November 6, 2009, the Court directed Petitioner OM Financial Life Insurance Company (“Old Mutual”), and Respondent the Securities and Exchange Commission (“SEC” or “Commission”), to submit additional briefing to address the question of the appropriate remedy, including vacatur *vel non*, in view of the Court’s holding in its July 21, 2009 Opinion that the SEC failed to properly consider Rule 151A’s effect upon competition, efficiency, and capital formation. Old Mutual believes that (1) as it has from the outset of this proceeding, vacatur of Rule 151A in its entirety is the most appropriate remedy here, and (2) remand with stay of the Rule’s effective date until two years following any reissuance of the Rule would provide relief that is considerably more appropriate than remand without stay.

Old Mutual filed its Petition for Rehearing to request that the Panel reconsider and modify the bare remand (i.e., remand without vacatur or stay) that it ordered in its July 21 decision. The Petition requests the Panel to order a remand *with* stay, to prevent serious injury to the fixed indexed annuities (“FIA”) industry while the SEC conducts a proper § 2(b) analysis and reconsiders Rule 151A. Old Mutual sought this more limited relief to alleviate the most injurious aspect of the remand-without-vacatur remedy—Rule 151A’s current January 12, 2011 effective date, which is causing competitive injury by requiring the industry to incur

immediate substantial costs that would be wasted if the SEC revises the Rule, or decides not to reissue it.¹ If, upon further consideration, the Court determines that vacatur is not warranted, Old Mutual again urges the Court to stay the Rule's effective date. This supplemental brief, however, focuses on the reasons why it would be most appropriate and beneficial for the Court to vacate Rule 151A.

ARGUMENT

I. VACATUR IS THE MOST APPROPRIATE REMEDY IN VIEW OF THE COURT'S CONCLUSION THAT THE SEC FAILED TO CONDUCT A PROPER § 2(B) ANALYSIS

During merits briefing, Old Mutual and its Co-Petitioners specifically requested vacatur. *See* Pet. Brief at 28 (“The rule should be vacated.”); *see also* Tr. of Oral Argument at 4 (“Indeed, we believe that the reasons set forth in our emergency motion for expedited review, which this Court granted, further warrant vacating the rule in the event the petition is granted.”). Although the Court held that the statutorily required § 2(b) analysis underlying Rule 151A was arbitrary and capricious, it ordered a remand without vacatur, leaving in place the January 12, 2011 effective date. Old Mutual petitioned the Court to modify the remedy and issue a remand with stay to avoid the immediate competitive injury to the FIA

¹ Old Mutual was also concerned that its Petition not be viewed simply as re-argument from the merits phase that vacatur was the appropriate remedy. Accordingly, the Petition for Rehearing sought a different and more limited remedy than vacatur that still would ameliorate the worst impact of the remand-only order.

industry that the extant effective date causes. While Old Mutual did not explicitly request vacatur in its Petition for Rehearing, it did indicate that vacatur also would be an appropriate remedy. *See* Pet. for Reh'g at 3, n.3 & 9, n.5.

Indeed, to support the remand-with-stay request, Old Mutual's Petition for Rehearing applies the same *Allied-Signal* standards that this Court uses to determine whether vacatur *vel non* is the appropriate remedy when a rule is held to be invalid or fundamentally flawed. *See* Pet. for Reh'g at 9 (“[B]ecause this case satisfies the *Allied-Signal* factors for vacatur of a rule, it also qualifies for the more limited remedy of a remand-with-stay.”). Consequently, the same *Allied-Signal* analysis provided in the Petition for Rehearing also supports the traditional remedy of vacatur.

The SEC's Response to the Petition for Rehearing attempts to skirt the question of whether a remand with stay (or vacatur) is an appropriate remedy, and focuses on two ancillary points. First, the SEC strongly implies that it is not required to do a § 2(b) analysis at all. *Resp. to Pet. for Reh'g* at 8-9. The SEC asserts that its position is validated by Old Mutual's failure to address this issue in detail in the Petition for Rehearing. *Id.* at 9. That is simply wishful thinking. Old Mutual's Petition for Rehearing is limited to the question of remedy, and therefore the issue of how the SEC itself (as opposed to its litigation staff) might reinterpret § 2(b) in the future was not central to the Petition. Moreover, the SEC's position

regarding avoidance of a § 2(b) analysis—which was newly minted for this litigation and not part of the rulemaking process—is simply wrong, and flies in the face of the fact that the SEC almost universally does a § 2(b) analysis in notice-and-comment rulemaking.²

Second, the SEC contends in its Response that Old Mutual advances only “speculative claims of harm” because Rule 151A is “not yet effective.” Resp. to

² Indeed, since § 2(b) was enacted, Old Mutual has not identified a single situation where the SEC did not do a § 2(b) analysis in connection with notice and comment rulemaking, including situations as mundane as operational issues internal to the SEC. *See, e.g.*, Adoption of Amendments to the Rules of Practice and Delegations of Authority of the Commission, 69 Fed. Reg. 13,166, at 13,172-74 (Mar. 1, 2004) (SEC finding that the rule related “solely to agency organization, procedure, or practice,” yet still required a § 2(b) analysis).

The reasons are clear why a § 2(b) analysis is required here. First, the plain language of § 2(b) covers all rulemaking where the SEC is “required to consider or determine whether an action is necessary or appropriate in the public interest.” 15 U.S.C. § 77b(b). SEC notice and comment rulemaking routinely concerns the public interest, as the SEC admits Rule 151A does here. *See* Resp. to Pet. for Reh’g at 8. Second, the SEC’s § 2(b) argument is utterly contrary to the legislative history of the statute. *See, e.g.*, H.R. Rep. 104-864, at 39-40 (1996) (Conf. Rep.); 142 Cong. Rec. 25,809-10 (1996) (statement of Rep. Bliley); *see also* H.R. Rep. No. 104-622, at 39 (1996) (Com. Rep.). Third, even assuming the SEC’s new reading of § 2(b) was correct—that a § 2(b) analysis is not triggered because the Rule is merely definitional—the SEC created exemptions for certain annuity contracts as part of Rule 151A (for example, the Rule applies to those fixed indexed annuities for which amounts payable are “more likely than not” to exceed amounts guaranteed by the annuity contract, thereby effectively exempting fixed indexed annuities which would not trigger the “more likely than not” test). By providing such exemptions, § 28 of the Securities Act explicitly requires consideration of the public interest, which in turn would trigger a § 2(b) analysis under even the SEC’s incorrect interpretation of the statute. *See* 15 U.S.C. § 77z-3.

Pet. for Reh'g at 13. That is untrue, and ignores the commercial reality that FIA issuers like Old Mutual must act now to prepare for the still looming January 12, 2011 effective date. Consequently, the concern here is not the harm that Rule 151A might cause Old Mutual and the FIA industry at some time in the future, it is that the existing January 12, 2011 effective date is causing substantial competitive harm right now. Indeed the SEC's Response only adds to the problem, by creating even more uncertainty. Resp. to Pet. for Reh'g at 3 ("It is also unclear at this juncture what action the Commission ultimately will take"). In short, there is nothing speculative at all about the competitive injury here, and the SEC's argument is simply wrong.

In sum, an *Allied-Signal* analysis demonstrates that, based on the circumstances of this case, vacatur is fully warranted, and that remand with stay is greatly superior to remand alone.

II. VACATUR WOULD BETTER SERVE THE PUBLIC INTEREST BY ENSURING THAT RULE 151A DOES NOT GO INTO EFFECT UNLESS AND UNTIL THE SEC CONDUCTS A PROPER § 2(B) ANALYSIS

As explained in the Petition for Rehearing, a remand with stay would eliminate the competitive harm that is occurring to the FIA Industry while the SEC reconsiders Rule 151A. *See* Pet. for Reh'g at 6-8. Vacating Rule 151A not only would prevent such injury to the industry, but also better serve the public interest

by ensuring that the SEC performs the rigorous § 2(b) analysis that this Court's decision envisions.

A. Vacatur Would Better Effectuate The Court's Mandate That The SEC Conduct A Proper § 2(b) Analysis

The Court found that the SEC's § 2(b) analysis was "lacking" because it "failed to properly consider the effect of the rule upon efficiency, competition, and capital formation." Op. at 3 & 24. Specifically, the Court rejected the SEC's competition analysis because "[t]he SEC could not accurately assess any potential increase or decrease in competition ... because it did not assess the baseline level of price transparency and information disclosure under state law." Op. at 22. Likewise, the SEC failed to determine "whether, under the existing regime, sufficient protections existed to enable investors to make informed investment decisions and sellers to make suitable recommendations to investors." *Id.* at 24. Finally, the SEC's efficiency analysis was "based significantly on the flawed presumption that the enhanced investor protections under Rule 151A would increase market efficiency." *Id.*

The new and probing § 2(b) analysis that this Court's decision requires the SEC to conduct serves two purposes. First, a proper § 2(b) analysis requires the SEC to assess whether it is, on balance, appropriate to enact Rule 151A in light of its speculative benefits as compared to its commercially adverse impact on competition, efficiency and capital formation. Second, a proper § 2(b) analysis

will provide a comparison of the current state of regulation and competition as compared to its projected future state so that the Court can assess whether the SEC's decision to adopt the Rule constitutes reasoned decision making in light of the § 2(b) considerations. In short, the analysis the Court has required of the Commission is integrally intertwined with the issue of whether adoption of a new Rule 151A is reasonable.

Although this Court explained in great detail how the SEC failed properly to consider each § 2(b) factor—competition, efficiency, and capital formation—the SEC's Response to the Petition for Rehearing gives every indication that the SEC has not begun to address the Court's concerns, and is not inclined to conduct a rigorous § 2(b) analysis. *Compare Op.* at 22 (“The SEC could not accurately assess any potential increase or decrease in competition, however, because it did not assess the baseline level of price transparency and information disclosure under state law.”), *with Resp. to Pet. for Reh'g* at 7-10 (SEC's lengthy suggestion why it need not conduct a § 2(b) analysis and believes reissuance of Rule 151A can be justified under § 2(b), apparently based on the current record). A less than rigorous § 2(b) analysis, however, is not in the public interest.

The situation here is a special one in the realm of rulemaking because there already is a comprehensive state regulatory structure in place. Rule 151A reflects the SEC's decision either to supplant that regulation or to provide a substantial

federal overlay of additional regulation. Given these circumstances, the Court recognized that a § 2(b) analysis was particularly important here, because that analysis goes to the heart of whether Rule 151A should be enacted at all. Put differently, the § 2(b) analysis is central to the rulemaking here, not some peripheral agency analysis like paperwork reduction considerations.

Indeed, this is exactly the type of situation Congress envisioned would be particularly appropriate for § 2(b) analysis. *See* H.R. Rep. 104-864, at 39-40 (1996) (Conf. Rep.) (“In particular, the system of dual Federal and state securities regulation has resulted in a degree of duplicative and unnecessary regulation. . . . The Managers agreed to include amendments to the Securities Act of 1933, and the Securities and Exchange Act of 1934 to eliminate duplication, promote efficiency and protect investors.”). For that reason, the Commission should re-examine Rule 151A from the ground up, with the § 2(b) analysis serving as an integral consideration in whether the Rule should be adopted at all. Only vacatur will ensure that the Commission does this, and for that reason it is the superior remedy.

B. Vacatur Would Provide Greater Certainty For The Industry

Vacatur also would guarantee that the new, proper § 2(b) analysis the Court is requiring the SEC to conduct, and any possible changes to Rule 151A, would be subject to renewed notice-and-comment rulemaking. That, in turn, would increase the likelihood that whatever the SEC does next, it will be based on a better

administrative record, and hopefully lead to more reasoned-decision making. That not only would inure to the public benefit, but also provide greater certainty to the industry that any new rule will make sense. Put differently, vacatur would begin to dissipate the cloud hanging over the industry, as each day brings the industry closer to January 12, 2011, and more and more resources are being expended.

III. REMAND WITHOUT VACATUR OR STAY PROVIDES NO BENEFITS TO OFFSET THE COMPETITIVE HARM IT CAUSES.

Finally, while it is clear that remand without vacatur or stay will cause significant competitive harm, it is also important to note that there are no offsetting benefits from a remand-only order. To elaborate, in some circumstances vacating a rule will cause interim harm that is more profound than the adverse impact of allowing an infirm rule to remain in effect. *See, e.g., North Carolina v. EPA*, 550 F.3d 1176, 1177 (D.C. Cir. 2008) (vacating the rule would have severely impaired important environmental protections covered by the rule); *Rodway v. U.S. Dep't of Agric.*, 514 F.2d 809, 817-818 (D.C. Cir. 1975) (vacating the existing regulations would have significantly disrupted the entire food stamp system). In those circumstances, a remand might be more beneficial than vacatur.

But here Rule 151A is not yet in effect -- it provides no benefits over the status quo of robust state regulation. *See* Opening Br. for Pet'r National Ass'n of Ins. Comm'rs at 13-14. Accordingly, in contrast to remand only, vacatur changes nothing as the current state regulatory system remains in place to protect investors

in either circumstance. *See Comcast Corp. v. FCC*, 579 F.3d 1, 9 (D.C. Cir. 2009) (recognizing the relevance of other laws safeguarding the public in the vacatur v. remand analysis); *Natural Res. Def. Council v. EPA*, 489 F.3d 1364, 1375 (D.C. Cir. 2007) (holding vacatur was not disruptive since parties were still subject to other environmental regulations). All remand without vacatur does is leave in place a vestigial January 12, 2011 effective date, that is causing current competitive injury to the FIA industry.³ In short, remand without vacatur or stay has nothing to commend it.

CONCLUSION

While the remand-with-stay remedy requested in Old Mutual's Petition for Rehearing is appropriate, beneficial and within the purview of the Court to grant, vacatur is the most appropriate remedy here. Consequently, Old Mutual requests that the Panel grant rehearing and modify its Opinion by vacating Rule 151A or, alternatively, remand Rule 151A with a requirement that the SEC stay the Rule's effective date until two years following any reissuance of the Rule.

³ Even the SEC concedes that it is likely the January 12, 2011 date will not be the actual effective date once it acts further, even while it insists that the date remain in effect while the Commission acts on remand. Resp. to Pet. for Reh'g at 11-12. The SEC's desire to have it both ways on the effective date contributes to the market uncertainty and competitive injury that Rule 151A is presently causing.

Respectfully submitted

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