
Future SEC Regulation of Indexed and Other Products in Question

BY GARY COHEN & KRISTIN SHEPARD

Although Rule 151A has been vacated by the U.S. Court of Appeals for the D.C. Circuit, legislatively overridden by the Harkin Amendment to the Dodd-Frank Act (DFA), and officially withdrawn by the SEC (see SEC Release No. 33-9152), questions regarding the potential securities regulation of indexed products remain.

The Harkin Amendment conditions indexed products' exemption from Section 3(a)(8) of the Securities Act of 1933 on meeting state standard nonforfeiture and suitability laws. Hence, questions arise such as whether synthetic products without cash values can meet state nonforfeiture laws and whether indexed life insurance — or indeed any other life insurance product covered by the Harkin Amendment — can meet state suitability standards designed for annuities.

Despite vacating Rule 151A, the Court of Appeals found the SEC to be "reasonable" in regulating indexed products under the Rule, and did not object to the "more likely than not" test articulated under that Rule. Consequently, questions arise as to whether the investment risk, marketing, and mortality risk tests traditionally used to determine the securities status of insurance products have been modified.

The Harkin Amendment is articulated in terms of "exemption" from the securities laws rather than "exclusion." Unlike "exclude[d]" products, exempt products remain subject to certain provisions of the federal securities laws, including the anti-fraud provisions. Although SEC Chairman Mary Schapiro has testified that the SEC has no plans to re-engage on this matter, query whether the SEC could bring actions against issuers of indexed and other products covered by the Harkin Amendment. In addition, DFA authorizes the SEC to adopt rules regulating broker-dealer point-of-sale disclosure of "investment products." Still unknown: whether the SEC might seize on this provision to regulate disclosure of indexed products notwithstanding the Harkin Amendment.

Finally, FINRA has sought to "regulate" indexed annuities through requirements regarding "outside business activities" of associated persons of broker-dealers and jawboning regarding "source of funds" to buy indexed annuities. Questions arise as to whether FINRA will continue to assert jurisdiction on these grounds.



Rule 151A is gone but clarity is still needed

STOLI and STOA Litigation: A Study In Contrasts

BY DAWN WILLIAMS

Due to a well-developed body of case law concerning stranger-originated life insurance (STOLI) transactions, an insurer facing such litigation often knows what to expect from both the opposition and the court. Recently decided cases involving stranger-originated annuity (STOA) transactions, however, indicate that such predictability does not necessarily extend to litigation involving these products.

Numerous federal courts have issued opinions concerning STOLI recently, with the majority finding in the insurer's favor due to a lack of insurable interest. Even less insurer-friendly outcomes – for example, the federal district court in Minnesota recently dismissed an insurer's cause of action for misrepresentation as barred by the incontestability

clause – have been reasonably foreseeable in light of case law precedent and the state statutory provisions that were at issue.

The path forward for STOA cases, however, may be considerably murkier – largely because of the different statutes and principles applied to annuities. At least one federal court has found that an insurer will not prevail on an insurable interest argument, and the federal district court in Rhode Island recently granted a motion for judgment on the pleadings against an insurer because it had not properly invoked a termination clause. On the other hand, a New York court in a similar case recently found in favor of the insurer, dismissing the counterclaims against it and discharging the insurer from liability.