

The Minutemen

When the SEC issued rule 151A, it thought it had an open and shut case against the fixed indexed annuity industry. It thought

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Eric Marhoun can still remember the moment when his summer vacation fell apart in 2008. He had just brought his family up to their cabin in Brainerd, Minnesota when he snuck off to check his e-mail. As the executive vice president and general counsel for Old Mutual Financial Network, he couldn't afford to be out of touch for very long, and this was a perfect chance to catch up with his inbox.

But the first thing he noticed was a bulletin that the Securities and Exchange Commission had issued Rule 151A, which declared that fixed indexed annuities (FIAs) were not insurance products, but securities. To a lay person, this was a seemingly insignificant distinction, but for Marhoun and the rest of the FIA business, it was a seismic change. Anybody selling FIAs would have to be licensed by the SEC, something many in the industry felt would hurt independent agents who primarily sell FIAs. Many felt the rule would change the nature of FIAs themselves, and essentially collapse the industry.

Marhoun's family was left to enjoy their vacation without him as he dialed into frantic conference calls and scheduled meetings with insurance commissioners for the following Monday. It would be the first in a long series of lost weekends for Marhoun, who became one of the first draftees in the FIA industry's nearly two-year-long fight for life. "All I can say is I'm glad my family has other interests than me," Marhoun says, wistfully.

Surprise attack

The battle over FIAs began in June 2008, when SEC Chairman Christopher Cox argued that because fixed indexed annuities were often sold abusively to seniors who did not understand the products, FIAs needed SEC oversight to protect the public. To make his point, he played a clip from an NBC Dateline segment in which reporter Chris Hansen went undercover to try to catch annuity sales reps making bogus sales. Hansen came up short, but the video had its intended impact. The SEC voted 5-0 to issue Rule 151A, and like



that, FIAs suddenly transformed from insurance to securities as far as the law was concerned.

For many in the industry, the SEC's ruling came as a surprise, mainly because the feeling was that annuities were clearly insurance products. The carriers bore the investment risk, and at no point had an annuity customer lost money because of market volatility. So what was the big deal?

For others, 151A was less of a shock. Two years previously, the National Association of Securities Dealers (now the Financial Industry Regulatory Authority, or FINRA) issued rule 05-50, which suggested that fixed indexed annuities should be regulated as securities. According to some in the FIA industry, this was a clear warning that few actually heeded.

But for Marhoun and many others in the FIA world, 151A was bad news. At the very least, it would require anybody who sold fixed indexed annuities to get licensed by the SEC, a costly process that would likely drive many smaller operators out of the FIA business. (For those already registered with the SEC, the rule was a non-issue.) According to Marhoun and others, this would, in turn, lead to fewer choices for consumers and seriously deplete the FIA market. It would also undermine the very nature of FIAs themselves. The idea was that governed under securities law, the FIA would become treated more like a security by manufacturers and distributors. Instead of offering 100% guarantee on returns, FIAs might begin offering 90% with a chance for greater returns, but also a greater risk to the value of the product itself. This would fundamentally change FIAs themselves.

Almost immediately, the SEC's motivations for issuing Rule 151A came into question. During the unusually short comment period that followed the rule's issuance (only 70 days), hard data on abusive sales failed to materialize. By the time the initial comment period closed in December 2008, the official reasoning behind the rule switched, no longer citing abusive sales practices, but instead noting that since fixed index annuities have investment risk built into them, they should be regulated as securities.

For many who opposed 151A, a host of urban legends and conspiracy theories arose to explain the SEC's real motivations. One claimed that the entire thing was orchestrated (or at least encouraged) by the NASD so it could gather regulatory fees on annuities activity. Another theory was that the rule was endorsed by variable annuity writers that could rely on the new regulatory requirements to weed out competition. The most sensational theory is that Cox himself took personal issue with fixed indexed annuities after his father almost purchased one and Cox found the sales approach distasteful. None of these stories have ever been substantiated, but they persist.

Whatever the reason, once Rule 151A had been issued, the FIA industry found itself with two choices: it could either find a way to live with this new rule, or it could fight the ruling itself.

It chose to fight.

The Judicial Battle

Shortly after 151A was proposed, Marhoun and the general counsels of some of the fixed indexed annuity industry's biggest companies—including Allianz Life Insurance



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Company of North America, American Equity Investment Life Insurance Company, American Investors Life Insurance Company, Aviva Life and Annuity Company, Conseco Insurance Company, EquiTrust Life Insurance Company, the Life Insurance Company of the Southwest, and Midland National Life Insurance Company—met to form the Coalition for Indexed Products, an industry legal team that would battle 151A in court. Prior to this, the industry did not have any kind of combined legal counsel. Over the course of the battle, trade groups, such as the National Association of Fixed Annuities (NAFA) and the Independent Fixed Annuities Agents Council (IFAAC), would get involved, but the Coalition felt it could mount a compelling legal challenge on its own.

“The rule was baseless. The biggest issue is it turns the concept of investment risk on its head by stating that persons have risk if they don’t have certainty as to what their return above a guaranteed rate will be,” Marhoun says. The other concern, he added, is the proposing release relied heavily on statements about sales practices that simply didn’t have a basis in fact as demonstrated by the statistics maintained by the NAIC.

“The rule’s redefinition of investment risk was dangerous because the potential for a return above a guarantee is true of so many insurance products. And insurance products have been exempt from securities regulation since 1933.”

The day 151A was adopted in the Federal Register, the Coalition filed a petition to challenge it. A few days later, the National Association of Insurance Commissioners, which worked closely with the Coalition, filed its own petition challenging the rule. An IMO in Florida also filed an amicus brief showing that the SEC had not looked at the impact of 151A on independent agents. In July 2009, the D.C. Circuit Court of Appeals ruled that the SEC had acted “capriciously and arbitrarily” in adopting Rule 151A. Furthermore, it found that the SEC did not prove the need for the rule against considerations of efficiency, competition and capital formation. However, the Court stopped short of declaring FIAs an insurance product, leaving the central language of 151A—which said FIAs were securities—intact.

To satisfy the Court, the SEC agreed to conduct a study of its own rule. Once the study was completed, a two-year implementation period would begin, during which time the FIA industry could get its SEC licenses. For those who opposed the rule, all of this bought precious time to mount a legal challenge.

At this point, Marhoun says, most of the Coalition companies shifted their energies to fighting 151A in the halls of Congress as well. Old Mutual, however, continued the battle in court on its own, asking the Court to vacate Rule 151A entirely. “There were other Coalition members in this fight that continued a strong legislative effort,” Marhoun says, “but they were concerned about bringing a petition that might unduly antagonize the SEC.”

Marhoun knew that since the Court never removed the January 2011 effective date from 151A, the door remained open for the SEC to renew its effort to regulate FIAs unless the rule was scrubbed entirely. For the better part of a year, Old Mutual and its allies awaited both the completion of the SEC’s study and the Court’s decision. Meanwhile, with the future of the FIA industry uncertain, sales languished. If the SEC satisfied the Court’s due diligence requirements, or if the Court rejected Old Mutual’s request to vacate, there was no telling what would become of the FIA industry.

However those fears vanished earlier this month, when the Court issued a ruling that vacated 151A. While the SEC brushed off the ruling, stating that 151A had not yet even gone into effect, the reality was the SEC would have to start all over again, most likely in Congress, if it wanted to pursue the matter any further. But as it was about to learn, that option was about to vanish, too.

The Legislative Battle

Nick Gerhart, vice president of compliance communication and associate general counsel for American Equity had remained in close contact with Marhoun all throughout the legal challenge to 151A. But by the time Old Mutual was heading to court, American Equity was part of a parallel effort to defeat 151A in the halls of Congress. The company was already involved in state legislative affairs in Iowa, which is considered the heart of the fixed indexed annuities industry. The skills Gerhart learned there served him well when the Coalition took its case to Washington lawmakers.

The most important thing was to engage high-level members of Congress, and for that, Gerhart turned to his Midwestern connections. “The lion’s share of the FIA industry is in Iowa and Minnesota. Iowa has a large number of carriers, and a lot of IMO’s are in the Des Moines area so it made sense that we spoke with our senior senators—Grassley and Harkin—and get them to see the impact 151A would have on jobs and consumers in Iowa. After that, it just came together.” But it didn’t come cheap. General estimates put the total legal and lobbying costs of the Coalition’s 151A efforts at several million dollars. A significant portion of this was travel and meeting costs. To build up legislative support in Congress, the Coalition organized several “fly-ins” in which agents and independent producers would congregate in D.C. to meet with legislators and voice their concerns over 151A. For Gerhart, organizing these events amounted to a second full-time job for himself and for his staff. But it paid off, as it brought into the effort people like Blair O’Connor, president of Producers Choice, an IMO based in Troy, Mich.



The Coalition needed “committed troops on the ground” to lobby for the cause, Gerhart said. When O’Connor came to his first fly-in last summer, he knew that was the role for him.

“In my first meetings with the D.C. offices of the Michigan delegation, I watched how the meetings went, and I realized this was more than a one-time close,” O’Connor recalls. “You really have to stay involved with these people because their initial goal is to listen to you and look compassionate. But if you don’t keep bugging them, they don’t want to get involved.”

To counter Capitol Hill’s legendary inertia, O’Connor went back home last August and began working with his local producers to develop a grassroots campaign based around the practice of what he calls “triple dipping.”

“We went to the agents in a district and we’d get them to write a letter, fax it to Washington, call Washington and then physically take their letter over to the local office of the representative.”

O'Connor credits the success of the campaign with this ability to encourage his own business contacts to get involved. According to him, carriers could not really ask IMOs to take action on 151A because of their manufacturer-client relationship. O'Connor, however, had no such restriction. "I can talk to my contemporaries more forcefully without worrying about losing my customer relationship with them," he says. "I had the ability to guilt marketing firms to do the things that the carriers didn't have the ability to do."

Ultimately, it all worked. Iowa Senator Tom Harkin (D) wrote an amendment to H.R. 4173, the financial services bill, that would classify FIAs governed by the standards developed by the NAIC as state-regulated insurance products. H.R. 4173 passed both the House and the Senate earlier this month, and is expected to be signed into law promptly. That, coupled with the court decision to vacate 151A, delivered the lethal one-two punch the Coalition had hoped for. 151A was dead. Ultimately, the SEC accepted defeat, and on July 20, 2010, it announced it would not pursue 151A any further. The industry had won.

The Aftermath

Despite this victory, Marhoun, Gerhart, O'Connor and everyone else they worked with are not celebrating too loudly. "We came as close as we could to sleepwalking into disaster," Marhoun says.

For Gerhart, the most enduring lesson from 151A is that the FIA industry needs to be engaged in the political process. "We did a horrible job of that until about a year ago," he says. "We did a great job coming together, and let's not lose sight of that. Who knows what the next fight will be? We could all be talking together three years from now on a totally different issue."

O'Connor agrees. "There will always be turf wars in this industry, and this will not be the last battle we will have to fight." Still, he believes that the skills and contacts forged during 151A will make it easier for the industry to defend its interests in the future. "What's apparent to a lot of people in D.C. is that we're a significant political force. All of the experts told us that we would never be able to stand up to the SEC. But we had the fortitude to accomplish something nobody gave us a chance on."

Something Marhoun, Gerhart and O'Connor all stress is that this was not something they accomplished on their own. This was a fight fought by the entire industry, involving hundreds of professionals. One name that comes up repeatedly is Iowa Insurance Commissioner Susan Voss. "Susan was unbelievable. And so was the whole NAIC. It stood firm," O'Connor says. "If we didn't have the NAIC support proving that it was a competent group of regulators for these products, we would never have won. That's how instrumental the NAIC and Susan Voss were."

Gerhart goes further. "Under her leadership, the Iowa Insurance Division has taken a strong stance with indexed annuities going back to 2005. If you go to any NAIC meeting, you'll hear other commissioners defer to her on this issue. She understands the product, the companies, how to regulate it, down to the consumers and the advertising. She understands the economic impact FIAs have on Iowa, but also that across the country, this is a



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viable product, a growing product with a strong demand, and one of the products that's going to save the retirement income crisis that's facing this country."

In the meantime, for those who have been living this battle for the last two years, it is time for some rest and recuperation. Marhoun still owes his family a summer vacation. Gerhart jokingly refers to the past 12 months as is "year in hell," and looks forward to a few quiet weekends at his lake house. And as for O'Connor? He's going on a six-week sabbatical from Producers Choice.

"For the last 90 days of this fight, I don't think I had a single good night's sleep," O'Connor says. "I was doing this thing 24/7 for close to a year. There wasn't a day when I didn't talk to Eric and Nick at least 10 times. Not one. But it was an unbelievable endeavor and I have to say it's the most fulfilling thing I've done in my career."

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