

Creative Marketing Comments on US Court of Appeals Decision on SEC Rule 151A

by Mike Tripses, President of Creative Marketing, NAFA Chair

July 24, 2009, Leawood, Kansas - The much anticipated U.S. Court of Appeals decision was announced July 21, 2009 on the issue of whether the SEC is allowed to implement Rule 151A designating most current FIA products as securities subject to SEC and FINRA regulation.

In a mixed decision, the Court granted the Petitioner (the Petitioner-Coalition includes Old Mutual, National Western, and American Equity) request by deciding, “the matter should be remanded to the SEC to address the deficiencies with its §2(b) analysis.” The Court called the SEC’s analysis flawed, arbitrary and capricious. This is a rebuff to the SEC, with no particular timeline for them to respond with the appropriate analysis. The “§2(b) analysis” of the 1933 Securities Act requires the SEC to analyze the effects of Rule 151A on capital formation, competitiveness and efficiency. Most of the 4,000+ who commented when the rule was proposed believed those effects would be negative. SEC spokesman Kevin Callanan said they would “continue to consider the procedural issue.” Joan Boros of counsel with Jordan Burt LLP, a Washington law firm specializing in securities law commented that fully considering the effects of a proposed rule is “a formidable and time-consuming task, and there is no assurance that the court will find that the SEC’s follow-up meets the statutory standard.” The process may require a new exposure for comment by the public.

The Court sided with the SEC on the core issue of whether FIAs leave sufficient risk with policyholders and so fail the exemption from securities regulation under §3(a) (8) of the 1933 Securities Act. Specifically, the Court said:

- **The SEC is to be accorded deference under the Chevron case to make these determinations** under its delegated regulatory authority by Congress. “Petitioner’s argument misses the mark because it interprets VALIC and United Benefit too restrictively.” “The language of §3(a) (8) does not unambiguously include FIAs within the...exemption.”
- **Petitioner’s view that the SEC has developed an “insupportable definition of investment risk... is not sufficient to establish that the SEC’s rule is arbitrary or capricious.” The Court did opine that the Petitioner’s view was a defensible one,** but that it is moot. Also, the SEC has been consistent in its’ position on investment risk, since, all FIAs today fail the technical requirement of Rule 151 that advance declaration of interest is needed to fall within the safe harbor. “We cannot hold that this interpretation is unreasonable.”
- **“In this case the SEC has adopted an interpretation (of the §3(a) (8) statute) that is based in reason... It is irrelevant that this Court might have reached a different-or better- conclusion than the SEC.”** Contrary to Petitioner’s assertion that the SEC has based its rule on an “an insupportable definition of investment risk,” the rule is not arbitrary or capricious, however much the SEC may think “Petitioner’s view is certainly a defensible one.”
- **The court did not buy the “Petitioner’s argument that SEC failed to balance the investment risks assumed by the insurer against those assumed by the purchaser...”** The Court said FIAs did not

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fall within the term “annuities” under the ’33 Act because FIAs “left a more than minimal risk upon the purchaser.” The SEC sets forth a test to distinguish between contracts based upon the risk borne by the purchaser. Such an approach is “reasonable.”

- **The SEC’s approach to Rule 151A does not need to account for the question of how FIAs are marketed.** The Court agreed that this was unnecessary, since the SEC was not unreasonable in concluding it “...would be inconsistent...and potentially misleading, to market the annuity without placing significant emphasis on the securities-linked return...” In other words, any sale made MUST emphasize its security-like characteristic.

What Happens From Here?

A number of writers have declared the Court’s ruling a victory. It is in the sense that getting swatted down this way, even on a procedural issue, is not good for the SEC and has occurred several times in recent years on various Rules they have promulgated. It is also good in that there is no Rule now if and until the SEC meets its requirements to provide a §2(b) analysis. As to future action:

- The SEC can argue to the court that §2(b) is inapplicable. Informed opinion is that this argument is highly doubtful and nearly without precedent.
- The SEC can resurrect the Rule by completing §2(b) (adequately or not) and publishing it in the Federal Register. The SEC can re-expose the Rule for comment (modified or not) but certainly including its §2(b) analysis).
- If the SEC does not do so by January 11, 2011 the issue is dead (unless later restarted by them).
- If the SEC continues and does the §2(b) analysis, we get to start again on defeating the rule. We can comment, await its withdrawal or adoption and in the latter case sue again on §2(b) issues.
- In the meantime, the legislative approach embodied in bills before both houses of Congress, if passed, can resolve the issue in one fell swoop.

Will the SEC proceed to restart its Rule? Will it do so? No one knows yet. It is important that everyone with a stake in the issue continue to support the industry effort against SEC Rule 151A. Help prevent the transformation of these low-risk, insurance products into securities by SEC fiat. Lobby your Congressional representatives in support of the Meeks-Price House bill H.R. 2733 and the Brownback-Nelson Senate Bill S. 1389. We also advocate you support this fight with financial contributions to NAFA - <http://www.nafa151a.com> and the Coalition for Indexed Products. Creative has made substantial contributions to both.



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