

May 12, 2009

SEC Rule 151A Update: U.S. Court of Appeals hears argument in Rule 151A lawsuit

By Leif Gustafson – Aviva USA Senior Corporate Counsel

On Friday, May 8, 2009, I attended the oral argument in *American Equity Investment Life Insurance Company, et al., v. Securities and Exchange Commission*, in Washington, D.C. This article provides a brief update on the oral argument and the current status of the lawsuit in opposition to SEC Rule 151A.

What's this case all about?

The lawsuit challenging Rule 151A was originally filed in the United States Court of Appeals for the District of Columbia Circuit by American Equity and three other fixed indexed annuity (FIA) issuers in January 2009, shortly after the rule's final adoption. (Although Aviva is not a named party, the Company continues to support this lawsuit.) The National Association of Insurance Commissioners (NAIC) also sued the SEC and that lawsuit was consolidated with the American Equity case in February 2009.

The lawsuit requests that Rule 151A be overturned because:

- It relies on a view of investment risk that is unsupported by prior caselaw;
- The SEC failed to take into account several factors noted in prior court decisions assessing the status of insurance and annuity products under federal securities laws, including the relative allocation of investment risk between the policyholder and the insurer, the manner in which the products are marketed, and the extent and nature of state regulation of the products and related sales practices;
- The SEC did not adequately consider the impacts of Rule 151A on efficiency, competition and capital formation.

In addition, the NAIC claims that Rule 151A improperly infringes on the states' regulation of insurance products.

The three-judge panel assigned to the case is comprised of Chief Judge David Sentelle, Judge Douglas Ginsburg and Judge Judith Rogers. Chief Judge Sentelle and Judge Ginsburg were appointed to the court by President Reagan in 1987 and 1986, respectively. (Judge Ginsburg also was nominated by President Reagan for appointment to the U.S. Supreme Court in 1987.) Judge Rogers was appointed to the court by President Clinton in 1994.

What the lawyers said

At the oral argument, Eugene Scalia (the son of U.S. Supreme Court Justice Antonin Scalia) presented on behalf of the industry, Rodney Page presented on behalf of the NAIC, and Deputy Solicitor Michael Conley presented on behalf of the SEC.

The issue receiving the most focus – both from the judges and counsel to the industry and the SEC – was the concept of investment risk that is the foundation for Rule 151A. The SEC argues that the investment risk that separates FIAs from traditional fixed annuities is the risk that policyholders may not realize their expectation that indexed-based returns will exceed guaranteed returns. The industry contends that this definition of investment

continued

risk is inconsistent with prior decisions of the Supreme Court and other federal courts. During the oral argument, both Chief Judge Sentelle and Judge Ginsburg asked questions that expressed skepticism about the concept of investment risk put forward by the SEC. In one exchange, Judge Ginsburg asked whether a traditional fixed annuity under which the issuer agrees to provide the policyholder with an annual allotment of lottery tickets would be subject to SEC regulation. Mr. Scalia also highlighted that Rule 151A is counterintuitive as drafted in that it would only classify an FIA as a security if it is “more likely than not” that the risk identified by the SEC will not come to pass.

In addition to the discussion concerning investment risk, Mr. Page presented arguments that the SEC overstepped its bounds by infringing upon state regulation of FIAs and failed to properly consider existing protective regulation by state insurance agencies in adopting Rule 151A.

What happens now?

A decision from the court is expected by late summer or early fall. Possible outcomes are as follows:

- The court upholds Rule 151A.
- The court vacates, or overturns, the rule. If this were to occur, the SEC would need to start a new rulemaking process afresh, if it wished to continue with efforts to regulate FIAs – something that most observers believe would be unlikely.
- The court rules that the substance of Rule 151A is acceptable, but that the SEC failed to properly analyze the rule’s impact on efficiency, competition and capital formation; and remands, or returns, the rule to the SEC to correct the flaws in its analysis. This result likely would increase, rather than decrease, the current uncertainty concerning Rule 151A.

Regardless of the court’s decision, it is possible that the ruling will be appealed to the U.S. Supreme Court. If the Supreme Court were to grant review of the appeal, the ultimate fate of the regulation of FIAs under federal securities laws would rest in its hands. If it were to deny review, the decision of the D.C. Circuit would stand as final.