Equity Index Insurance: SEC Proposed Rule 151A
These comments with regard to Proposed Rule 151A represent my personal perspectives, and not the position of my employer. The SEC discussed many of the issues involving Equity Index Annuities (EIAs) in conjunction with its adoption of the “Safe Harbor Rule” (Rule 151). Those issues were reiterated in 1997 when the SEC solicited input on appropriate administration of securities laws with regard to EIAs.
It would be inaccurate for carriers, marketing organizations, agents and state insurance regulators to say EIA regulation has been completely successful. Conumer, FINRA, and securities industry representatives have often shown index annuities as being sold unsuitably. Of Missouri’s consumer complaints on annuities, 90% of Missouri annuity complaints involve EIAs, most regarding suitability in sales to seniors.
Regarding SEC Proposed Rule 151A, the following observations seem significant: 1. Considerations received on contracts which provide variable benefits are usually added to separate accounts. Equity index products provide variable benefit values (i.e., benefit values are not determined in advance), but generally no separate account is established. State definitions of "variable" contracts seem to depend upon establishment of a separate account; failure to establish separate accounts seems designed to avoid the "variable" classification, which in turn affects their regulation under state filing, licensing, reserving, nonforfeiture, suitability and disclosure laws. But requiring separate accounts seems generally reserved to securities regulators, i.e., the SEC.
2. To protect asset adequacy, EIAs need matching assets. If assets are purchased to satisfy liabilities for a contract with variable values, it seems most prudent to hold them in a separate account. State insurance laws limit the ability of insurers to invest funds in futures and equities in the general account, which restricts flexible designs for EIAs.
3. These contracts do not appear to qualify under SEC Rule 151 for exemption from Section 3(a)(8) of the 1933 Securities Act. The SEC discussion in its Rule 151 adopting release said, "an insurer which uses an index feature externalizes its discretionary excess interest rate, and thus shifts to the contract owner all of the investment risk regarding fluctuations in the rate. ... The insurer, therefore, would be permitted to specify an index to which it will refer, no more often than annually, to determine the excess rate that it will guarantee under the contract for the next 12-month or longer period." If the insurer fails to disclose the likelihood that this contract is a security, it may deceptively affect the risk purported to be assumed. Virtually all EIAs use an index to determine excess interest to be credited for the previous period (often 12 months), not to fix the rate for the next 12 months.
4. Using an index to determine the credited rate on existing funds shifts investment risk from the insurer to the contract owner. Investment risk seems the linchpin in Otto v. VALIC (as well as Rule 151), which concluded insurance was a security when interest was not guaranteed prospectively for at least 12 months. Virtually no EIAs guarantee the interest rate prospectively for any period.
5. To avoid being misleading, deceptive, or false, contracts and associated marketing, disclosure, and illustration material must adequately disclose important product features. When indexed values are included in an insurance product, marketers often emphasize them in touting product advantages. State insurance departments cannot determine whether such material will satisfy the marketing test of SEC Rule 151. But because the index is an integral part of EIAs, emphasis on the index could violate the marketing test.
6. If product benefits are based on an index, it seems misleading to represent them as nonvariable. Furthermore, issuing an EIA as nonvariable may deceptively affect the risk purported to be assumed by the insurer, in that the insured assumes a major portion of the investment risk. However, these possible violations of state insurance laws are not generally recognized, in part due to confusion over SEC views on risk transfer. It may be difficult for some insurers issuing EIAs to comply with Proposed Rule 151A.
Most EIAs are issued without separate accounts. However, this misrepresents their true nature, makes their provisions misleading, and deceptively affects the risk purported to be assumed.   It seems essential to consistent, adequate, and reasonable regulation for the SEC to clarify the securities status of EIAs. The same also seems appropriate to extend to any annuity contracts which include a market

value adjustment (MVA). This would logically extend to indexed and MVA life insurance.
While the prospective nature of Proposed Rule 151A would only affect contracts issued after its effective date, it leaves the question open as to whether EIAs and MVA contracts issued prior to the rule are securities. Primary responsibility for compliance rests with insurers, who would presumably still be answerable to consumers and courts with regard to previously unregistered products. Proposed Rule 151A would do much to help consumers concerned about such contracts, level the playing field, and strengthen state insurance regulation.