ORAL ARGUMENT SCHEDULED FOR FRIDAY, MAY 8, 2009

No. 09-1021 (Consolidated with No. 09-1056)

IN THE UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT

AMERICAN EQUITY INVESTMENT LIFE INSURANCE COMPANY, *et al.*,

Petitioners,

v.

SECURITIES AND EXCHANGE COMMISSION,

Respondent.

On Petition for Review of Final Rule of the
United States Securities and Exchange Commission

BRIEF OF *AMICI CURIAE* AARP, METLIFE, INC. AND NORTH AMERICAN SECURITIES ADMINISTRATORS ASSOCIATION, INC. IN SUPPORT OF RESPONDENT

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CORPORATE DISCLOSURE STATEMENTS

Pursuant to Circuit Rule 26.1, *Amici* state as follows:

MetLife, Inc. is a leading provider of insurance, employee benefits and financial services with operations throughout the United States and the Latin America, Europe and Asia Pacific regions. MetLife, Inc. has no parent corporation and no publicly held corporation owns 10% or more of MetLife, Inc.'s, stock.

The Internal Revenue Service has determined that AARP is organized and operated exclusively for the promotion of social welfare pursuant to Section 501(c)(4) (1993) of the Internal Revenue Code and is exempt from income tax. AARP also is organized and operated as a non-profit corporation pursuant to Title 29 of Chapter 6 of the District of Columbia Code (1951).

AARP has no parent company and issues no stock, therefore no publicly-held company has a 10% or greater ownership interest in AARP. Other legal entities related to AARP include AARP Foundation, Legal Counsel for the Elderly, Focalyst, AARP Global Network, AARP Services, Inc., and AARP Financial, which offers AARP members AARP mutual funds and, through a third-party provider, an annuity product

The North American Securities Administrators Association, Inc. ("NASAA") is a not-for-profit membership corporation formed and operating under the District of Columbia Nonprofit Corporation Act. NASAA's membership includes the state securities regulators in all 50 states, the District of Columbia, Puerto Rico, and the U.S. Virgin Islands. NASAA is operated for the purpose of supporting the work of its members and advancing the cause of investor protection in connection with the offer and sale of securities. NASAA further states that it has no parent corporation and that no publicly held corporation owns 10% or more of NASAA's stock.

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GLOSSARY

ACLI	American Council of Life Insurers
AEILIC	Petitioner American Equity Investment Life Insurance Company
Aviva	Aviva USA Corporation
Coalition	Coalition for Indexed Products
FINRA	Financial Industry Regulatory Authority
JA	Joint Appendix
NAFA	National Association of Fixed Annuities
NAIC	Petitioner National Association of Insurance Commissioners
NAIFA	National Association of Insurance and Financial Advisors
NASD	National Association of Securities Dealers
RA	SEC Regulatory Addendum

STATEMENTS OF INTEREST

I. AARP

AARP is a non-partisan, non-profit organization with more than 40 million members, dedicated to addressing the needs and interests of people aged 50 and older. As the largest membership organization representing the interests of older Americans, AARP is very concerned about deceptive and fraudulent practices in the indexed annuities market.

At the same time that Social Security provides proportionately less of needed retirement income and traditional employer-sponsored defined benefit pension coverage has decreased, Americans have also departed, in unprecedented numbers, from their historic practice of relying primarily on federally-insured products for their retirement needs. Older people, many of whom are investing in securities markets for the first time, are frequent targets of improper sales practices because they often have significant assets and are seeking investment opportunities to supplement the Social Security and pension benefits they will receive during retirement. While investment fraud hurts people of all ages, older people are hit harder because they have fewer opportunities to recoup their losses. Integrity in the securities markets and fulfillment of fiduciary duties by various actors on whom investors rely are more important than ever.

AARP thus has made combating securities fraud a high priority. AARP has undertaken efforts to enhance investors' low financial literacy and to educate them about how to choose financial professionals who will act in their best interest. These include a "Free Lunch Monitor" program, in which consumers attend free investment seminars and may use an AARP-NASAA-approved checklist to document activities that do not adhere to guidelines set by securities regulators. *See* AARP, "Become a Free Lunch Seminar Monitor" (Mar. 2009), http://www.aarp.org/money/consumer/articles/no_free_lunch_digital.html. *See also* AARP, "Campaign for Wise and Safe Investing" (May 2006), http://www.aarp.org/money/consumer/articles/campaign_for_wise_and_safe_investing.html (state securities regulators partnered with AARP state offices to run programs aimed at helping investors avoid scams). AARP also has been very involved in commenting on legislative and regulatory proposals that address improper sales practices, including this rulemaking, and filing *amicus* briefs in cases involving the interpretation and application of federal and state securities laws. AARP is filing this brief because federal securities regulation is necessary to protect the many thousands of older people whose retirement security is harmed when they buy indexed annuities that are inappropriate for their circumstances.[1]

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1 AARP submitted a notice of consent of all parties to file a brief as *amicus curiae* on February 9, 2009. MetLife affiliates previously sold AARP-branded long-term care insurance.

II. MetLife, Inc.

MetLife, Inc. ("MetLife") is a leading provider of insurance, employee benefits and financial services with operations throughout the United States and the Latin America, Europe and Asia Pacific regions. Through its subsidiaries and affiliates, MetLife reaches more than 70 million customers around the world and is the largest life insurer in the United States (based on life insurance in-force). The MetLife companies offer life insurance, annuities, auto and home insurance, retail banking and other financial services to individuals, as well as group insurance and retirement and savings products and services to corporations and other institutions.

MetLife is acting as an *amicus curiae* in this proceeding to demonstrate that federal regulation of indexed annuities as securities is an appropriate exercise of the SEC's rulemaking authority, and is consistent with how courts and the SEC have analyzed the status of variable annuities and other insurance products under the securities laws.[2] As one of the largest sellers of annuity products in the United States, MetLife has an interest in ensuring that all annuities, including indexed annuities, are properly regulated. While MetLife does not issue indexed annuities, similarities between indexed and variable annuities may cause purchasers to confuse these annuities or otherwise impute improper marketing of indexed

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[2] MetLife moved for leave to act as *amicus curiae* in this proceeding on March 17, 2009.

annuity products to other industry participants. Inadequate regulation of indexed annuities thus tarnishes the reputation of other annuity issuers, including MetLife, and the insurance industry as a whole.[3]

III. North American Securities Administrators Association, Inc.

NASAA is the non-profit association of state, provincial, and territorial securities regulators in the United States, Canada, and Mexico. It has 67 members, including the securities regulators in all 50 states, the District of Columbia, Puerto Rico, and the U.S. Virgin Islands. Formed in 1919, NASAA is the oldest international organization devoted to protecting investors from fraud and abuse in the offer and sale of securities.

NASAA's members are responsible for regulating securities transactions under state law, and their principal activities include registering local securities offerings; licensing the brokers and investment advisers who sell securities or provide investment advice; and initiating enforcement actions to address fraud and other misconduct. They are intimately familiar with the investment offerings and sales abuses confronting their state residents on a daily basis, including indexed annuities.

NASAA supports all of its members' activities, and it appears as *amicus*

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3 MetLife is expressing no opinion in this brief with respect to state or federal regulation of products other than indexed annuities.

curiae in important cases involving securities regulation and investor protection. NASAA has an interest in defending 17 C.F.R. § 230.151A ("Rule 151A") because it will provide urgently needed protections for investors.[4]

SUMMARY OF ARGUMENT

While AARP, MetLife, and NASAA (collectively "*Amici*") have different views on many issues and approach this case from different perspectives, they each filed comments in support of Rule 151A and they are filing this brief due to their shared belief that indexed annuities should be regulated under the federal securities laws, in addition to state insurance laws, as are variable annuities. This brief focuses on three of the primary reasons *Amici* support Rule 151A.

First, there is no substantive reason for indexed annuities to be regulated differently than variable annuities under the securities laws. Indexed annuities have key securities characteristics, including the assumption of investment risk by investors, and they are marketed as a means for investors to participate in securities market gains—features shared by variable annuities. Despite their similarities, however, variable annuities are regulated under both state insurance laws and federal securities laws, as they have components of both securities, with an investment tied to the performance of the securities markets, and insurance, with

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4 NASAA sought leave to participate as *amicus curiae* in this proceeding on March 17, 2009.

guarantees against certain risks. By contrast, indexed annuities, which are similar to variable annuities in both respects, are regulated solely under state insurance laws, which were not designed to address the investment-related characteristics of a financial product. Requiring indexed annuities to be regulated as securities is not only logical, it will also ensure a level playing field for indexed and variable annuities. The sellers of variable annuity products are at a distinct competitive disadvantage to the extent that sellers of indexed annuities operate under a different set of rules that are less comprehensive, less uniform, and less consistently applied. Rule 151A remedies this disparity.

Second, consumers around the country continue to be harmed by deceptive practices in the sale of indexed annuities. Indexed annuities are extremely complicated investments due to their intricate formulas and hidden costs. Yet, these investments are "sold to unsophisticated investors without the regulatory safeguards afforded to purchasers of similar investments." Craig McCann & Dengpan Luo, Securities Litigation & Consulting Group, *An Overview of Equity-Indexed Annuities* 13, June 2006, http://www.slcg.com/pdf/workingpapers/EIA%20Working%20Paper.pdf. As described below, deceptive and misleading sales practices that take advantage of this complexity are all too often used to sell indexed annuities. In particular, many older persons are investing in the nation's securities markets for the first time, yet they often are ill-equipped to navigate the complexities of indexed annuities. They thus rely on a range of professionals who recommend indexed annuities that may be unsuitable for their individual circumstances.

Third, the most effective way to address these problems is to regulate indexed annuities as securities under federal law, which will subject them to stronger and more uniform standards, in addition to state insurance law. State insurance regulation is inadequate, by itself, to protect investors from the complexities, risks, and aggressive marketing tactics associated with securities, such as indexed annuities. In general, insurance regulators do not have at their disposal the equivalent of the disclosure requirements, suitability standards, and anti-fraud measures found in the securities laws. Moreover, their approach to enforcement varies considerably and is not adequate to address the problems that often arise in the offer and sale of securities. As a result, private citizens and state attorneys general have been prompted to seek remedies in court for deceptive practices in the sale of indexed annuities.

By virtue of Rule 151A, licensing standards under the securities laws will help ensure that agents have the requisite knowledge, character, and supervision to sell these complex investment products. In addition, mandatory registration of indexed annuities as securities will greatly increase the amount of information available to investors concerning their features, risks, and costs. Perhaps most importantly, the strong anti-fraud provisions and suitability standards that have been a part of securities regulation for decades will deter abuses in the sale of indexed annuities and provide more effective remedies for those who are victimized.

Accordingly, *Amici* respectfully urge the Court to uphold Rule 151A.

ARGUMENT

I. INDEXED ANNUITIES ARE SECURITIES, LIKE VARIABLE ANNUITIES, THAT SHOULD BE REGULATED UNDER THE FEDERAL SECURITIES LAWS

An indexed annuity is a type of deferred annuity contract that accrues interest based on changes in an index of securities, such as the S&P 500 Index.[5] Like a variable annuity, mutual fund, or other security—and unlike a fixed annuity—an indexed annuity's return to its investors is directly and explicitly linked to the performance of the securities markets. In adopting Rule 151A, the SEC appropriately recognized that indexed annuities should be regulated under the federal securities laws because they share key characteristics with variable

[5] The three most common crediting methods for indexed annuities are (i) "benefit cap," in which interest is credited based on the performance of a securities index up to a set percentage; (ii) "participation rate," in which interest is credited as a percentage of the total appreciation of the index; and (iii) "spread/margin/asset fee," in which a fixed percentage is subtracted from any appreciation in the index linked to the contract in order to determine the interest credited. *See* RA 159-160.

annuities and other securities. *Amici* believe that the SEC's decision was well-founded and ultimately will benefit investors and the insurance industry as a whole.

A. Indexed Annuity Owners Bear A Form of Investment Risk With Respect To Fluctuations In Market Performance

Section 3(a)(8) of the Securities Act of 1933 excludes from the definition of a security "any … annuity contract" that is "issued by a corporation subject to the supervision of the insurance commissioner … of any State." 15 U.S.C. § 77c(a)(8). Over a number of years, however, federal courts and the SEC have acknowledged that products developed since the exemption was enacted in 1933, such as variable annuities, are not eligible for this exclusion based on an analysis of certain factors. *See generally SEC v. Variable Annuity Life Ins. Co.*, 359 U.S. 65 (1959) ("*VALIC*"); *SEC v. United Benefit Life Ins. Co.*, 387 U.S. 202 (1967) ("*United Benefit*"). One key factor is the way in which investment risk is allocated between insurer and purchaser.

In adopting Rule 151A, the SEC engaged in the type of inquiry that the courts directed in *VALIC, United Benefit*, and their progeny for determining whether indexed annuities qualify as securities. Courts have largely distinguished those insurance products that place significant investment risk on the owner (*e.g.*, variable annuities) from those products where an insurer has assumed sufficient investment risk (*e.g.*, fixed annuities). Rule 151A is a logical extension of these decisions. It provides that indexed annuities are regulated under the federal securities laws only if the owner assumes investment risk in that "[a]mounts payable by the issuer under the contract are more likely than not to exceed the amounts guaranteed under the contract." 17 C.F.R. § 230.151A(a)(2).

As the SEC recognized, the owner of an indexed annuity assumes meaningful investment risks. That is, an indexed annuity owner bears the risk that his or her investment will return little or no gain above the minimum guaranteed in the contract based upon the performance of the securities markets. While Petitioners try to minimize the significance of the purchaser's assumption of this investment risk, it is the mirror image of the purchaser's opportunity to participate in market gains that these products offer. A contract holder who receives no return on an indexed annuity investment above the guaranteed minimum, because of poor investment performance, is likely to be disappointed in the product; if all that investor expected was the guaranteed minimum, he or she—if fully informed through adequate disclosure—would simply have purchased a traditional fixed annuity, as these products generally have much shorter surrender charge periods, lower surrender charges,[6] and a higher effective guaranteed return. *See* RA183. In short, the purchaser of an indexed annuity assumes investment risk in return for a

[6] A surrender charge is a charge paid by the contract owner upon the withdrawal of their investment, in whole or in part, prior to a stated period.

potential gain, just like any other securities investor.

A fixed annuity owner, by contrast, does not bear such risk. The sole risk with respect to a fixed annuity is that the insurer will become insolvent and unable to meet its contractual obligations. This insolvency risk is fundamentally different from the investment risk the purchaser assumes with either an indexed or variable annuity. For this reason, insurance regulators, with their focus on insurer solvency, are well suited to be the sole regulator of fixed annuities, as described below. By contrast, because the investment performance of indexed annuities is directly linked to the securities markets, which are subject to regulation by the SEC under federal securities laws, the SEC should regulate these products as well.[7]

Rule 151A also incorporates another factor courts have analyzed in determining whether an annuity should be regulated under the federal securities laws: whether the interest rate is set prospectively (like a fixed annuity) or

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7 Indexed annuity issuers recently have begun labeling indexed annuities as "*fixed* indexed annuities," rather than "equity indexed annuities" or merely "indexed annuities," in an effort to obscure the fact that their returns are generally based on the returns of a securities index. But, as Justice Brennan recognized in *VALIC*, labeling an annuity as "fixed" does not automatically exempt it from the federal securities laws. Instead, "the functional distinction that Congress set up in [the 1933 exemption] must be examined to test whether the contract falls within the sort of investment form that Congress was then willing to leave exclusively to the State Insurance Commissioners." *VALIC*, 359 U.S. at 76 (Brennan, J., concurring). Justice Brennan's rationale clearly focuses on evolutionary change in insurance products, not insurance law. Therefore, under Section 3(a)(8), products that create the type of investment risk the federal securities acts were intended to address are to be regulated under those acts, regardless of their label.

retrospectively (like a variable annuity). *See Assocs. In Adolescent Psychiatry, S.C. v. Home Life Ins. Co.*, 941 F.2d 561, 567 (7th Cir. 1991) *("Home Life")*. *Home Life* notes that an insurance company, as opposed to the contract holder, will assume significant investment risk if an investor has certainty as to the minimum and excess rates of interest that will be credited prior to the upcoming contract year. The court contrasted this type of instrument with the instruments in *VALIC* and *United Benefit*, noting that in the latter cases "the buyer paid money; the seller held it for a time, *after* which it announced the rate of interest to be credited. The *ex ante* uncertainty about that rate made the 'annuity' look like a mutual fund, with the seller supplying only investment advice." *Id.* at 567. A similar degree of uncertainty applies to indexed annuities, given the volatility of market performance in any given year. Rule 151A recognizes this key distinction between prospective and retrospective interest rate crediting, subjecting an annuity to federal securities regulation if "[t]he contract specifies that amounts payable by the issuer under the contract are calculated at or after the end of one or more specified crediting periods ... by reference to the performance during the [prior] crediting period or periods." 17 C.F.R. § 230.151A(a)(1), (2).

Petitioners attempt to minimize the similarities between indexed and variable annuities, asserting that "[e]xcept for th[e] interest crediting feature, the essential attributes of [indexed annuities] are identical to traditional fixed annuities." Opening Brief of Petitioners American Equity Investment Life Insurance Company, *et al.* ("AEILIC Br.") at 6-9; *see also* Opening Brief of Petitioner NAIC ("NAIC Br.") at 2-3. But this argument simply proves *Amici*'s point. The interest crediting feature, under which the purchaser assumes an investment risk, has proven to be dispositive in determining whether an indexed annuity is a security under relevant case law. *Compare Otto v. Variable Annuity Life Ins. Co.*, 814 F.2d 1127, 1140-42 (7th Cir. 1986) (product is a security where interest is credited retrospectively) *with Home Life*, 941 F.2d at 567 (product is insurance where interest is credited prospectively). While Petitioners focus on other purported differences between indexed and variable annuities, these differences are of far less significance in determining whether the annuitant or the insurance company bears investment risk.

Petitioners also argue that Rule 151A is misguided because an indexed annuity contains a "guaranteed" return and the purchaser thus does not bear the risk of a total loss of principal. *See* AEILIC Br. at 39-44. This argument assumes that "principal risk" (the risk of losing one's principal) is the only type of risk that matters, and ignores the role of investment risk (the risk of receiving little or no gain on a securities investment). *VALIC*, *United Benefit*, and their progeny have made clear, however, that an annuity can be subject to the federal securities laws even if the insurance company bears principal risk. As the *United Benefit* Court held:

> [W]hile the guarantee of cash value based on net premiums reduces substantially the investment risk of the contract holder, the assumption of an investment risk cannot by itself create an insurance provision under the federal definition. The basic difference between a contract which to some degree is insured and a contract of insurance must be recognized.

387 U.S. at 211 (citation omitted).[8] Indeed, if the assumption of principal risk by an insurance company were the sole determinative factor, one could argue that a variable annuity with a guaranteed minimum benefit rider, which protects the owner's cash value against market declines, should be exempt from regulation under the federal securities laws. This is not the law under *United Benefit*. *See id.*

Finally, Petitioners ignore the real possibility of a loss of principal that exists with an indexed annuity. While indexed annuities are sometimes marketed as "guaranteeing" a return on premium, product charges, such as surrender charges, often deplete any principal "guarantee" so the contract holder does not receive a

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8 The "Flexible Fund" annuity at issue in *United Benefit* contained a "guarantee" of cash value, largely analogous to the "guaranteed" return in an indexed annuity, requiring the insurer to bear a principal risk. Under this annuity, the purchaser agreed to pay a fixed monthly premium until a specific maturity date. 387 U.S. at 205. The premium, less a deduction for expenses, was subsequently invested by the insurer. *Id.* "At maturity, the purchaser may elect to receive the cash value of the policy, measured either by his interest in the fund or by the net premium guarantee, whichever is larger." *Id.* In other words, the insurer largely assumed the risk of loss of the customer's principal investment—but the Court still held that the annuity was outside the scope of Section 3(a)(8).

full return of his or her investment if the annuity's investments fail. *See* RA179. An indexed annuity also will frequently "guarantee" only a partial return of principal. *See* RA161-62.[9] Under these circumstances, an indexed annuity owner also bears a portion of the principal risk.

B. Indexed Annuities Are Marketed Like Securities

Because indexed annuities differ from fixed annuities in their potential for investors to participate in securities market gains, insurers, by necessity, market them by reference to these potential gains.[10] Marketing materials for fixed annuities, by contrast, are geared to appeal to purchasers primarily on the basis of stability and security, not the investment prospect of sharing in the growth of the securities market. Interest rates for fixed annuities generally are set in advance by

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9 Petitioners acknowledge as much when they note that under state non-forfeiture laws, indexed annuities must have only a guaranteed minimum contract value at least 87.5 percent of premiums after any costs and charges are applied. AEILIC Br. at 6.

10 The Supreme Court emphasized that the marketing of a product may be a significant factor in favor of a conclusion that the product is a security. *See United Benefit,* 387 U.S. at 211 (annuity "considered to appeal to the purchaser not on the usual insurance basis of stability and security but on the prospect of 'growth' through sound investment management."). In an analogous context, this Court has held that the marketing of a promissory note as a security is a "one-way ratchet" in that "[i]t allows notes that [otherwise] would not be deemed securities . . . . to be treated as securities if the public has been led to believe they are [but] does not, however, allow notes which [otherwise] would be deemed securities to escape the reach of regulatory laws." *Stoiber v. SEC*, 161 F.3d 745, 751 (D.C. Cir. 1998) (citing *Reves v. Ernst & Young,* 494 U.S. 56 (1990)).

the insurer based on its expectations for future investment earnings, operating expenses, mortality, taxes, competitive factors, and the like. Thus, there is no expectation on the part of investors in fixed annuities that strong market performance will result in higher excess interest rates, or even that excess interest above the minimum will be paid.

Unlike fixed annuities, both indexed and variable annuities are marketed as providing the possibility of significant market gains. In the case of indexed annuities, investment return based on the performance of a securities market index is an explicit contractual term, and it is precisely the possibility of participation in this performance, held out by the issuer, that attracts purchasers to indexed annuities. As a result, it would be inconsistent with the character of indexed annuities to market them as anything but an investment in the securities markets. A purchaser who does not want to bear any investment risk associated with variations in the returns of a securities market should purchase a fixed annuity, not an indexed annuity. The inherent marketing of indexed annuities as securities confirms that, by definition, they are securities that should be regulated under the federal securities laws.[11]

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11 Petitioners argue that Rule 151A is improper because the SEC failed to explicitly address how indexed annuities are marketed. AEILIC Br. at 45-46. However, the SEC's Adopting Release recognized that the inherent nature of indexed annuities necessitates that they be marketed with an emphasis on the opportunity they offer to participate in the securities

These problems have led various regulators and organizations to caution the public about indexed annuities. In an Investor Alert, the Financial Industry Regulatory Authority ("FINRA") has warned about the complexity of indexed annuities: "Although one insurance company at one time included the word 'simple' in the name of its product, indexed annuities are anything but easy to understand." FINRA, "Equity-Indexed Annuities -- A Complex Choice," http://www.finra.org/Investors/ProtectYourself/InvestorAlerts/AnnuitiesAndInsurance/p010614 (last visited Apr. 3, 2009). According to FINRA, "[o]ne of the most confusing features of an EIA [equity indexed annuity] is the method used to calculate the gain in the index to which the annuity is linked. To make matters worse, there is not one, but several different indexing methods." *Id.* The variety and complexity of these methods make it hard for investors to compare one indexed annuity to another.

Similarly, a warning from Florida's Chief Financial Officer stated that the widespread interest in indexed annuities is due, in part, to the fact they "are often

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by several attorneys general); Gary S. Mogel, *Equity Index Annuity Insurers are Facing More Lawsuits*, Investment News, May 7, 2007, *available at* http://www.investmentnews.com/apps/pbcs.dll/article?AID=/20070507/FREE/70507008/1009/TOC&ht=mogel20equity20index20mogel20equity20index20mogel20 equity20index (discussing suits brought by several attorneys general and quoting President of Continental Five Insurance Group that "[b]ecause contracts are loaded with incentives to push products of certain insurers, producers' livelihoods depend on placing production goals over the clients' best interest.").

touted as a vehicle for investors to realize stock-market-like gains without the risk, a 'best of both worlds' marketing strategy that has proven appealing to risk-averse seniors." Alex Sink, Fla. Dep't of Fin. Servs., "Equity Indexed Annuity Alert," http://www.myfloridacfo.com/consumers/guides/life/annuity_alert.htm (last visited Apr. 3, 2009). Moreover, "indexed annuities are complicated products that are difficult to understand. Uninformed consumers are often targeted by unscrupulous agents employing deceptive sales practices, and equity indexed annuities have become a prime vehicle for this kind of fraud." *Id.* The warning further states that while variable annuity products "require an agent to possess both an insurance license and a securities license to be able to sell such products, equity indexed annuities may be sold by life insurance agents who have taken and passed a 40-hour licensing course and state life insurance exam." *Id.*

Lawsuits by attorneys general and injured purchasers illustrate the complexity of indexed annuities and reveal a pattern of abusive practices. For example, in *Strube v. Am. Equity Inv. Life Ins. Co.*, the court certified a class action filed on behalf of approximately 23,000 class members who alleged "a wrongful scheme to develop, market, advertise, and sell . . . 'equity indexed annuities' through a centrally organized strategy, targeting senior citizens as potentially vulnerable buyers." 226 F.R.D. 688, 691 (M.D. Fla. 2005). In approving a proposed settlement, the court summarized the complaint, which described a standardized sales process in which an agent met with an elderly prospective purchaser, established a relationship of trust and confidence, and gave an incomplete and misleading description of the product. *Id.* at 692. Not only were the agents unable to provide an appropriate amount of information about the product, but customers were unaware of extremely high sales commissions that "fostered the use of high pressure and deceptive sales tactics" and created "an environment in which the agents are effectively encouraged to 'do whatever is necessary to make a sale.'" *Id.*

The lawsuit alleged misrepresentations and omissions in American Equity's sales materials that are typical of sales materials produced by companies that issue these products. They led purchasers to believe, among other things, that (i) they would be able to establish a retirement income flow they could not outlive when, in reality, they could not annuitize until a date beyond their life expectancy; (ii) withdrawals could be made virtually without penalty when, in fact, purchasers would incur substantial penalties for withdrawals made within the first fifteen years; and (iii) tax deferral was a key benefit, while American Equity knew that many of the investments class members surrendered in order to buy the indexed annuities already were tax deferred, and that indexed annuity distributions would be taxed as ordinary income with no stepped-up basis upon the annuitant's death. *Id*; *see also* Am. & Restated Consent J., *State v. Am. Equity Inv. Life Ins. Co.*, No.

27-CV-07-8236 (Minn. Dist. Ct. Feb. 7, 2008) (consent judgment in which insurance company agreed, among other things, to obtain information about an applicant's assets and disposable income in order to make a suitability determination, and conduct "elevated review" of consumers aged 65 and older who meet certain asset, income and anticipated future expense criteria).

Another suit by the Minnesota Attorney General alleged that Allianz, a proposed *amicus curiae* in support of Petitioners in this case, sold indexed annuities to "Minnesota senior citizens without regard for the suitability of the annuity to the seniors." Compl. at ¶ 1, *Minn. v. Allianz Life Ins. Co. of N. Am.*, No. 27-CV-07-581 (Minn. Dist. Ct. Jan. 9, 2007). According to the Complaint, the indexed annuities Allianz sold to seniors restricted "access to their money to pay for their daily expenses before the maturity date of the annuity," which often exceeded their life expectancy, and contained "immediate" bonuses, which could not be collected for as long as 15 years. *Id.* As illustrations, the complaint describes several people in their 60s, 70s, and 80s to whom Allianz sold deferred annuities even though they told sales agents they needed access to their money for living expenses and who learned only after they received the contract documents or even worse, when they experienced health problems and needed additional cash, that their investment carried large penalties for early withdrawals. *Id.* at ¶¶ 3, 4, 24-34.

Allianz's *amicus* brief describes the special steps it takes in selling indexed annuities to people 65 and older. Corrected Br. of Allianz Life Ins. Co. of N. Am. as *Amicus Curiae* in Supp. of Pet'rs at 13-14, *Am. Equity Inv. Life Ins. Co. v. SEC*, No. 09-1021 (consolidated with No. 09-1056) (D.C. Cir. Mar. 5, 2009). Yet, these "enhanced" practices confirm that indexed annuities pose special concerns for older people. Moreover, Allianz states that its adoption of these "advanced 'best practices'" is evidence of effective state regulation and that "Rule 151A is not warranted in light of the substantial legal protections afforded by state insurance regulation, as implemented by insurers such as Allianz, that are applicable to index annuities." *Id.* at 13, 15. Allianz does not disclose that it agreed to implement these practices in its settlement with the Attorney General of Minnesota, not as a result of state insurance regulation. Consent J. *State v. Allianz Life Ins. Co.*, No. 27-CV-07-581 (Minn. Dist. Ct. Oct. 8, 2007). These forced changes belie Allianz's claims that it changed its practices based on state insurance regulation which, it submitted, makes Rule 151A unwarranted. *See also Mooney v. Allianz Life Ins. Co.*, No. 06-545 ADM/FLN, 2008 WL 4402188, at *1 (D. Minn. July 28, 2008) (denying motion to decertify class of consumers who alleged fraudulent marketing of indexed annuities promising "'up- front' or 'immediate' bonus, when in actuality the bonus was not available until years after the products were purchased."); *Negrete v. Allianz Life Ins. Co.*, 238 F.R.D. 482, 488 (C.D. Cal.

2006) (certifying nationwide class of approximately 200,000 people 65 and older on RICO claims and California subclass of more than 33,000 on state law claims alleging Allianz "'illegally target[ed] seniors for the purpose of selling them inferior deferred annuity products . . . .'").

Other companies also have been sued concerning abusive practices in the sale of indexed annuities. For example, the Illinois Attorney General filed a lawsuit challenging the use of unsolicited mailers to older persons containing statements such as "Important Elder Law Update" and "Change in Your Medicare Benefits," and which urged consumers "to respond to these advertisements for 'vital information' by mailing a postage paid reply card that includes their signature, birth date, telephone number, and county of residence." Compl. at ¶¶ 20, 21, *State v. Senior Benefit Servs. of Kan., Inc.*, No. 2006CH520 (Ill. Cir. Ct. Aug. 25, 2006). Call center agents contacted people who returned the cards to determine if they were "qualified prospects," i.e., age 55 to 85, total estate value in excess of $100,000, minimum liquid assets of $20,000, and not an attorney, CPA, insurance agent, banker, financial planner, or stockbroker. *Id.* at ¶¶ 22-27. Agents scheduled in-home appointments for qualified prospects with an insurance agent who had an exclusive commission agreement with Senior Benefit Services. *Id.* at ¶ 28. After obtaining information on the person's assets, the agent began the "'annuity presentation,'" intended to show consumers they had financial problems the agent could "'fix.'" *Id.* at ¶¶ 36-37. According to the attorney general, the defendants did not disclose that the mailers were lead-generating devices and the purpose of the appointment was an annuity sales presentation by an insurance agent. *Id.* at ¶ 72i, ii.

Hundreds of people scheduled appointments in response to the mailers, and "[m]any, if not most, of the annuities sold through this scheme, are deferred equity indexed annuities with significant surrender charges (17% for the first three years) that extend for as long as 14 years. The significant and lengthy surrender charges make these annuities unsuitable for most elderly consumers." *Id.* at ¶ 51. One woman described in the complaint thought she was meeting with an estate planner from a government-sponsored senior advocacy program, not the insurance agent who persuaded her to use $170,000 from an IRA invested in mutual funds, nearly her entire liquid assets and life savings, to buy an indexed annuity with significant surrender charges issued by American Investors Life Insurance Co. She later learned of the annuity's significant surrender charges and the fees associated with liquidating her IRA and realized it was not suitable for her. She was unable to resolve her complaints with the insurance agent, Senior Benefit Services, or American Investors, and mediation through the attorney general's office failed as well. *Id.* at ¶¶ 58-70.

As the foregoing discussion demonstrates, indexed annuities frequently are sold without adequate disclosures and without regard to whether they are appropriate for the purchasers (or, perhaps, because several of their features make them inappropriate). The harm to these investors is great, particularly older people who placed their trust in salespeople who pretended to be acting in their best interest. Class actions and attorney general lawsuits have stopped some abusive practices and provided restitution to some investors, but their reach is limited. This demonstrates that the current regulatory structure governing indexed annuities is insufficient to remedy abuses, as more fully described in the next section.

III. FEDERAL SECURITIES LAW WILL PROVIDE SIGNIFICANT INVESTOR PROTECTIONS

Regulating indexed annuities under federal securities law is necessary because state insurance law alone does not adequately protect investors from the risks inherent in these products, as described in Section I, or from the sales abuses associated with them, as described in Section II. Indexed annuities must be subject to a regulatory regime that mandates full disclosure to investors, imposes strong antifraud standards, and deters misconduct through aggressive enforcement. Federal securities law offers these protections. State insurance law, on the other hand, is largely focused on preventing the insolvency of insurance companies that issue annuities. Consequently, the consumer protections applicable to indexed annuities under state insurance law are generally less comprehensive, less uniform, and less aggressively enforced than the investor protections available under the securities laws. While some states have recently begun to incorporate stronger consumer protection standards into their insurance laws, a comprehensive, nationwide regulatory scheme has not been achieved. Moreover, regardless of this evolution, federal securities law will always be necessary to provide safeguards against misconduct in the offer and sale of any financial product that constitutes a security—including indexed annuities.

A. Federal Securities Law Provides Investor Protections That Are Essential For Addressing The Risks Associated With Indexed Annuities

Indexed annuities must be subjected to the strongest possible disclosure requirements to ensure that investors can adequately assess the true risks and costs they face. A leading expert on indexed annuities has explained the importance of comprehensive disclosure in these terms:

> The [disclosure] proposed by the SEC is needed because issuers of existing equity-indexed annuities obfuscate the investment risks to which investors are exposed by repackaging what is actually a simple underlying investment with a layer of virtually worthless bells and whistles. . . . A direct consequence of the lack of SEC oversight is that investors in equity-indexed annuities cannot determine the true costs they incur when purchasing these investments and cannot effectively compare equity-indexed annuities to alternative investments such as stocks, bonds, and mutual funds.

Craig J. McCann, *An Economic Analysis of Equity-Indexed Annuities*, at 5, Sept. 10, 2008 (submitted with NASAA's comment letter to the SEC on proposed Rule

151A). Unless indexed annuities are regulated as securities in accordance with Rule 151A, investors in many states who are offered these products will not have the benefits of full disclosure and will continue to suffer the disadvantages that Dr. McCann describes.

The registration process under federal securities law addresses this need. The registration rules require issuers to disclose all material information about an offering to investors in a prospectus. That prospectus is subject to SEC review and the SEC has the authority to issue stop orders if the registration statement contains untrue statements or omissions of material fact. 15 U.S.C. § 77h(d); *see also* 77 U.S.C. § 77e(a), (b) (prohibiting the sale of securities unless a registration statement is effective and a prospectus complying with the Securities Act has been delivered to investors). These disclosure requirements help ensure that investors have access, either directly or through intermediaries such as research analysts and investment advisers, to the information they need to assess the risks and costs associated with a security.[13] The SEC's Adopting Release specifies some of the most helpful disclosures about indexed annuities that will be required under the

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13 The importance of disclosure in the registration process is highlighted in the SEC's regulations, which provide that in addition to specific disclosures required under the rules and forms, registration statements must set forth "such further material information, if any, as may be necessary to make the required statements, in the light of the circumstances under which they were made, not misleading." 17 C.F.R. § 230.408.

securities laws, including information revealing costs, methods of computing returns, and benefit options. *See* RA 245.

Strong and uniform sales practice and antifraud rules are also necessary to deter misrepresentations and omissions in the marketing of indexed annuities. Federal securities laws address these needs as well through robust antifraud provisions that prohibit misrepresentations, omissions, and schemes to defraud, in both written and oral communications with investors. *See, e.g.,* 15 U.S.C. § 77q (prohibiting fraud by "any person" in the offer or sale of securities); 15 U.S.C. § 78j(b) (similarly prohibiting fraud); 15 U.S.C. § 80b-6 (prohibiting fraud by investment advisers). The SEC and the courts have been applying these antifraud provisions for decades, resulting in strong, clear, and uniform standards of conduct.

Indexed annuities typically have long surrender periods during which investors cannot access their funds without paying substantial penalties or losing accrued interest. This feature may make indexed annuities inappropriate for some investors, especially older persons. An important regulatory antidote for this type of abuse is a strong suitability standard. Federal securities regulation has for decades imposed suitability requirements on firms selling securities of all types. *See* NASD Conduct Rule 2310 (the basic suitability rule adopted by the NASD and approved by the SEC). The Rule provides that when recommending the purchase or sale of any security, members must have reasonable grounds for believing that the recommendation is suitable in light of the investor's other securities holdings and financial needs. Conduct Rule 2310(a). The Rule also requires members to seek information from investors about their financial circumstances. Conduct Rule 2310(b). In 2007, the SEC approved new suitability requirements specifically designed to address the danger of investor confusion that may arise in the sale of variable annuities. *See* FINRA Regulatory Notice 07-53 (Nov. 2007) (announcing the adoption of Conduct Rule 2821). Indexed annuities are at least as complex and potentially confusing as variable annuities and warrant the application of an equally strong and consistently applied suitability standard.

In order for the disclosure, anti-fraud, and suitability standards described above to have a meaningful impact, they must be accompanied by strong sanctions and an aggressive enforcement program. The federal securities laws incorporate both of these elements. Congress has provided the SEC with a comprehensive set of remedies that it can invoke to halt violations, restore ill-gotten gains to victims, and deter future violations of the law. Those remedies include injunctions, restitution orders, monetary penalties, and licensing sanctions to rid the industry of those who cannot be trusted to treat investors fairly. *See generally* 15 U.S.C. §§ 78u through 78u-3; *see also* 15 U.S.C. § 78u-2 (establishing civil monetary penalties in tiers ranging from $5,000 to $100,000 for individuals). In addition, FINRA has the authority to impose heavy fines and licensing sanctions against the firms and agents who violate the Conduct Rules, which include the suitability standards described above. FINRA routinely enforces those suitability standards and related supervisory obligations in disciplinary proceedings involving variable annuities. *See generally* FINRA Monthly and Quarterly Enforcement Actions, *available at* http://www.finra.org/Industry/Enforcement/Disciplinary Actions/MonthlyActions/2008/index.htm; *see also The O.N. Equity Sales Co.*, FINRA Case #EAF0401040001 (reported Sept. 2008) ($70,000 fine and censure for firm's failure to maintain adequate supervisory system, resulting in variable annuity exchanges and replacements without information material to a suitability determination); *Brian Anthony Zirnheld*, FINRA Case #2006005319701 (reported Mar. 2008) ($10,000 fine and one-year suspension for unsuitable recommendation of a variable annuity to customers with dementia).

Violations of federal securities acts are also punishable by serious criminal penalties. *See* 78 U.S.C. § 78ff (providing for fines up to $5 million and imprisonment for up to 20 years for individuals); 77 U.S.C. § 77x (providing for fines up to $10,000 and imprisonment for up to five years). Civil liability in private actions for securities fraud is well-established, and represents an important complement to governmental enforcement efforts. *See, e.g.*, 15 U.S.C. § 77k (civil liability for false registration statements); 15 U.S.C. § 77l (civil liability for a false prospectus); *Superintendent of Ins. v. Bankers Life & Casualty Co.*, 404 U.S. 6

(1971) (noting the established private right of action for securities fraud under 15 U.S.C. § 78j(b)); *Basic Inc. v. Levinson*, 485 U.S. 224, 230-31 (1998) (observing that the private cause of action for violations of Section 10(b) and Rule 10b-5 constitutes an "essential tool for enforcement of the 1934 Act's requirements").

B. State Insurance Regulators Have Fewer Investor Protection Tools At Their Disposal

The record in this rulemaking makes clear that state insurance regulators have taken steps in recent years to enhance their consumer protection standards, based upon a recognition that indexed annuities have been the subject of significant abuses and that more regulation is necessary. Nevertheless, the consumer protection standards applicable to indexed annuities under state insurance law are weaker than the comparable investor protection standards applicable to variable annuities through the complementary system of federal securities and state insurance regulation. A review of Petitioners' briefs and the comment letters submitted in opposition to Rule 151A reveals gaps in the states' approach to disclosure, suitability, and enforcement under their insurance laws with respect to indexed annuities. Moreover, while those briefs and comment letters tout the strengths of state insurance regulation, they appear to contain few if any references to enforcement actions taken by state insurance commissioners on behalf of consumers who have been the victims of fraud or abuse in the marketing and sale of indexed annuity products.

Petitioners and many commentators rely largely on the states' adoption of various NAIC model rules to support their claim that consumer protections with respect to indexed annuities under state insurance law are strong and widespread. But only some states have adopted those model laws. *See generally* NAIC Br. at 3-7. To address this problem, Petitioners and other opponents of Rule 151A argue that voluntary industry compliance figures prominently in the regulatory scheme for indexed annuities. *See* Aviva Letter at 29, *available at* http://www.sec.gov /comments/s7-14-08/s71408-1733.pdf (asserting that the firm complies with the most stringent NAIC models, regardless of whether they have been adopted in states where sales occur); Coalition Letter at 22 n.17, JA 261 (asserting that many model laws have been accepted as a "floor" of conduct, regardless of whether states have adopted them). However, while voluntary industry compliance is certainly praiseworthy, it is less effective in regulating conduct than a mandatory industry-wide standard.

The briefs and comment letters also describe a number of laudable consumer protection initiatives aimed at addressing the types of problems associated with indexed annuities, but those initiatives are just being developed and it is unclear what investor protection benefits they will ultimately yield. Examples include the formation of NAIC working groups to enhance agent training and improve the regulation of annuity sales, Aviva Letter at 27; NAIFA Letter at 7, *available at* http://www.sec.gov/comments/s7-14-08/s71408-1716.pdf; the increased use of "Buyers Guides or other disclosure materials" among "a growing number of states," NAFA Letter at 97, *available at* http://www.sec.gov/comments/s7-14-08/s71408-1744.pdf; and a pilot program initiated in Iowa with the ACLI "to ensure that adequate disclosures are uniformly made to consumers in annuity sales," NAIC Letter at 2, JA 83. One industry organization promises to work with the NAIC and the states "to find ways to enhance the state regulatory structure to address the concerns that the [SEC] and others have raised about the marketing and sale of indexed annuities." NAIFA Letter at 7. These and similar statements throughout the record may signify positive developments, but they actually support the implementation of Rule 151A by acknowledging the problems surrounding indexed annuities and the need for federal regulation to complement the states' approach.

Additionally, enforcement of state insurance laws regulating indexed annuities is inconsistent. Many opponents of Rule 151A concede that abuses have occurred in the sale of indexed annuities, but their briefs and comment letters do not provide evidence of consistent enforcement by insurance regulators aimed at addressing those abuses. Instead, comment letters from both NAFA and NAIFA clearly indicate that state regulators typically focus more on complaint handling procedures than active enforcement programs. *See* NAIFA Letter at 8; NAFA

Letter at 105. While those procedures may provide relief to the individual consumers who complain, they are not as comprehensive as the federal securities laws in helping other investors who have been subjected to abusive sales practices. As a result, those procedures do not represent as significant a deterrent against misconduct as the enforcement provisions of the federal securities laws. In short, a system for resolving consumer complaints, while valuable, is no substitute for the nationwide application of the securities laws, with their strong enforcement philosophy tailored to address problems in the marketing of all securities products, including indexed annuities.

The NAIC's model rules on annuity disclosure and suitability illustrate some of the difficulties with state insurance regulation described above. While the NAIC first issued its Annuity Disclosure Model Regulation in 1978, the NAIC indicates that only 15 states have adopted this regulation. *See* NAIC Br. at 3. The NAIC issued its Suitability in Annuity Transactions Model Regulation ("NAIC Suitability Rule") in 2006, replacing the initial 2003 version that only protected investors over the age of 65. The NAIC indicates, however, that only 29 states have adopted laws or regulations based on the NAIC Suitability Rule. *See* NAIC Br. at 7.

The NAIC Suitability Rule also illustrates substantive concerns. For example, it limits the use of penalties that might serve as a deterrent to misconduct.

It provides that "any applicable penalties . . . may be reduced or eliminated . . . if corrective action for the consumer was taken promptly after a violation was discovered." *See* NAIC Suitability Rule at § 7B. Moreover, a drafting note under the same section states that "State insurance departments may wish to consider [a consumer's right to seek arbitration] when determining whether to bring an action requiring corrective action. . . ." Rather than serving as a strong deterrent against the types of widespread abuses described in Section II above, these provisions could foster the view that violators can satisfy regulators through full or partial restitution to the individual victim, without additional consequences. By contrast, the federal securities laws reflect a greater emphasis on enforcement and deterrence, in addition to remediation for injured investors. In addition, investors have private rights of action to address inappropriate sales of variable annuities under the applicable securities laws and regulations, as well as FINRA's rules. *Cf.* NAIC Suitability Rule § 1B.

The inability of state insurance law to fully address the risks posed by indexed annuities not only highlights the need for complementary federal regulation, it also validates the legal basis for Rule 151A. As Justice Brennan explained in *VALIC,* the exemption in Section 3(a)(8) was not intended to encompass annuities presenting novel forms of risk that state insurance laws generally were ill-equipped to regulate. *VALIC,* 359 U.S. at 76 (Brennan, J., concurring). Justice Brennan's interpretation of Section 3(a)(8) applies with full force to indexed annuities. They pose inherent risks and complexities far different from those typical of the insurance and annuity policies that Congress was content to exempt from regulation in the 1933 Act. *Id.* at 91. In addition, most state regulation has proven to be no "substitute" for the protections afforded under federal securities law. *Id.* at 85-86. Accordingly, the rationale for the exemption in Section 3(a)(8) clearly does not apply to indexed annuities, and they should be subject to federal regulation as securities under Rule 151A.

CONCLUSION

For the foregoing reasons, *Amici* respectfully request that the Court uphold Rule 151A as a valid, necessary exercise of the Commission's regulatory authority.

Dated: April 10, 2009

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CERTIFICATE OF COMPLIANCE

1. This brief complies with the type-volume limitation of 8,750 words, established in this Court's Order of February 13, 2009, because this brief contains 8,639 words, excluding the parts of the brief exempted by Fed. R. App. P. 32(a)(7)(B)(iii) and Circuit Rule 32(a)(1).

2. This brief complies with the typeface requirements of Fed. R. App. P. 32(a)(5) and the type style requirements of Fed. R. App. P. 32(a)(6) because this brief has been prepared in a proportionally spaced typeface using Microsoft Word in 14 point Times New Roman type.

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Dated: April 10, 2009

CERTIFICATE OF SERVICE

I hereby certify that on this 10th day of April, 2009, I have caused to be served two true and correct copies of this Brief of *Amici Curiae* in Support of Respondent upon the following, by overnight delivery:

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