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Following is a preliminary draft.

SEC PROPOSES SWEEPING CHANGES FOR FIXED INDEXED ANNUITIES

After more than 10 years of silence on the securities status of fixed indexed annuities, at an open meeting held on June 25, 2008, the SEC unanimously voted to propose a new rule that would require SEC registration for the offering of certain types of fixed indexed annuities. The SEC also unanimously proposed a new rule that would provide conditional relief to insurers from the periodic reporting requirements of the Securities Exchange Act of 1934, as amended ("Exchange Act").

SEC Chairman Cox began the meeting by noting that the rulemaking initiative was "very much" the product of a three-year collaboration between the SEC and NASAA (the North American Securities Administrators Association) in addressing senior sales practice issues. After sharing some brief statistics on investor complaints brought by seniors, in what is hopefully not the sum and substance of the support for this administrative action, Cox played for the audience an excerpt from the April 2008 NBC Dateline report called "Tricks of the Trade," which purports to reveal abuses in the sale of fixed indexed annuities.

A description of the proposed rules as discussed at today's open meeting appears below. Copies of the proposed rules were not made available at the meeting, so this description is based on oral remarks made at the meeting.

PROPOSED RULE 151A

Proposed rule 151A under the Securities Act of 1933, as amended ("Securities Act") would set out a new definition of "annuity contract" that would ***prospectively*** define certain fixed indexed annuities as not being an "annuity contract" or "optional annuity contract" for purposes of the exclusion from securities registration provided by Securities Act Section 3(a)(8).

Scope of Proposed Rule 151A. Proposed rule 151A would exclude from the coverage of Section 3(a)(8) fixed indexed annuity contracts regulated as annuities under state insurance law that have the following characteristics:

(1) the amounts payable by the insurer under the contract are calculated in whole or in part by reference to the performance of a security, including a group or index of securities, and

(2) the amounts payable by the insurer under the contract are more likely than not to exceed the amounts guaranteed under the contract ("more-likely-than-not" test).

Conclusive Determination. Proposed rule 151A would be "principles based" and would provide that an insurer's determinations regarding the more-likely-than-not test would be conclusive ***if:***

(1) the insurer's methodology, including economic, actuarial, and other assumptions, are "reasonable,"

(2) the insurer's computations are "materially accurate," and

(3) the determination is made not earlier than six months prior to the date on which the form of contract is first offered, but not more than three years prior to the date on which the particular contract is issued.

In response to a question from Commissioner Atkins regarding how the more-likely-than-not test would be administered, Associate Director Susan Nash responded that the proposed rule takes into account "variability," and that the staff considered the fact that insurers undertake a similar analysis as part of their pricing of the product. She also stated that insurers would need to make a periodic "redetermination" (presumably at least every three years) as circumstances such as market conditions change and as insurers gain more experience. When questioned by Commissioner Atkins, Nash acknowledged that due to this redetermination an annuity contract could be deemed to be a security during one period and not a security during another period. Nash further stated that in some cases, an insurer's determination at the outset would be "it."

Prospective Application. Proposed rule 151A would apply ***prospectively***, which, according to the SEC staff, would mean that it would not apply to fixed indexed annuities issued prior to the effective date of the final rule (if adopted) . Thus, the same annuity contract could have a different status under the federal securities laws based upon when it was issued. In response to a question from Chairman Cox on the reason for prospective application, Susan Nash replied that because many insurers have had to operate without guidance from the SEC and have relied on their own analysis, under these circumstances the staff did not believe it appropriate to subject insurers to additional legal risk relating to their past offers and sales as a result of this proposal and its eventual adoption. She noted, however, that once the proposed rule becomes effective, all indexed annuities, pre-existing contracts or new contracts sold after 12 months from the effective date may need to be registered depending on the determinations made under the proposed rule.

Effective Date. The proposed effective date would be 12 months after publication of the final rule (if adopted) in the Federal Register.4

PROPOSED RULE 12h-7

Proposed rule 12h-7 would provide a conditional exemption from the periodic reporting requirements of the Exchange Act that would apply to insurers that issue fixed indexed securities that are registered under the Securities Act and subject to state insurance law regulation, as well as guarantees of such securities that are subject to such regulation, ***but not*** other types of

securities, such as common stock, issued by insurers. The proposed rule would, therefore, apply to annuities that are required to be registered whether they be fixed indexed annuities, annuities with market value adjustment features, so-called "synthetic" annuities, or other securities that are registered under the Securities Act and regulated as insurance under state law.

Conditions of Proposed Rule 12h-7. Reliance on proposed rule 12h-7 would be subject to compliance with three conditions:

(1) the insurer must file an annual statement of its financial condition with, and the insurer must be supervised and its financial condition periodically examined by, the insurance regulator of the insurer's "home state,"

(2) the securities with respect to which the exemption is claimed may not be listed, traded, or quoted on any exchange, alternative trading system, interdealer quotation system, electronic communications network, or any other similar system, network, or publication, and

(3) the insurer must take steps "reasonably designed" to ensure that a trading market for the securities does not develop.

PRELIMINARY OBSERVATIONS ON PROPOSED RULE 151A

Proposed rule 151A is sweeping in its scope. The rationale for the proposed rule, however, would appear to be thin. In addition, the analytical construct in the proposed rule would appear to completely ignore the Supreme Court's deliberations of and decisions on the securities status of annuities, as well as the analysis of the *Malone* court.

Although the SEC's staff expressed the view that proposed rule 151A does not present "any possibility" of pre-emption, it is not entirely clear that the proposed rule does not raise issues under the McCarran-Ferguson Act.

What is clear, however, is that proposed rule 151A evidences the SEC's view, and perhaps also the view of FINRA and NASAA, that notwithstanding recent initiatives state insurance regulation of fixed indexed annuities is not sufficient.

When questioned on whether state regulation was sufficient, Nash acknowledged recent initiatives by the NAIC and individual states to regulate various aspects of marketing fixed indexed products, but noted that state insurance regulation is primarily focused on the solvency of insurance companies and not on sales activities.

Commissioner Atkins said that he preferred the SEC's taking a rulemaking, rather than an enforcement approach. He objected to an approach that would seek to establish the securities status of fixed indexed annuities through SEC enforcement action.

Susan Nash referred to the fact that "investor" protection would be enhanced through sales through registered broker-dealers subject to FINRA oversight.

The SEC meeting did not address fixed indexed life *insurance*, as distinguished from fixed indexed annuities. So, it is not clear whether the scope of proposed rule 151A is limited to annuities.

The SEC meeting did not reveal the source of the more-likely-than-not test. In a conversation following the meeting, an SEC staff official refused to tell us the source. The test does not appear to derive from the Supreme Court decisions in the VALIC and United Benefit decisions.

The SEC meeting did not discuss whether proposed rule 151A would have any impact on Rule 151 in connection with fixed declared rate annuities.

Commissioner Atkins declared that he was interested in whether the benefits of proposed rule 151A would outweigh the costs involved. He said that he would look at the comments made in this regard.

A clearer understanding of the SEC's analysis and support for its position may be forthcoming when the release is available. It may then also be possible to evaluate what level of protection from liability the announced prospective nature of the rule may provide.

It is anticipated, including by the SEC staff, that comments will be extensive and penetrating.

PRELIMINARY OBSERVATIONS ON PROPOSED RULE 12h-7

Proposed rule 12h-7 would exclude insurers eligible to rely on it from the requirements of the Sarbanes-Oxley Act of 2002 ("SOX") to the extent they would be subject to it by reason of the registration of the subject annuities.

The basis for the rule expressed by the SEC staff has been the general absence of a trading market for these products.

Our comments are obviously preliminary in nature and we will provide our clients and friends both continuing analysis and a thorough review once the proposed rules are published.

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