

New Rule 151A Published by SEC

The Securities and Exchange Commission's new Rule 151A regarding indexed annuities has been posted on the SEC Web site at <http://www.sec.gov/rules/final/2009/33-8996.pdf>.

As you are aware, Rule 151A was intended to clarify the status under the federal securities laws of indexed annuities. The new rule defines certain contracts as not being "annuity contracts" under the exemption contained in Section 3(a)(8) of the Securities Act of 1933.

The SEC noted that this action will provide purchasers of indexed annuities all of the consumer protections of the federal securities laws, including disclosure, antifraud, and sales practice protections.

Several modifications to the rule as initially proposed were made.

As pointed out by NAVA and many other commenters, the definition in the rule as proposed was overly broad and could be interpreted to apply to other types of fixed annuities and life insurance products. The Final Rule Release states that the definition was modified to respond to these concerns.

Accordingly, the first part of the two-prong test for contracts that the rule would place outside Section 3(a)(8) was changed to limit its applicability to contracts where the amounts payable by the issuer under the contract are calculated at or after the end of one or more specified crediting periods, in whole or in part by reference to the performance during the crediting period or periods of a security, including a group or index of securities.

The Release makes it clear that it is indexed annuities which are the subject of the rule and it is not intended to apply to traditional fixed annuities. The Release also states that Rule 151A does not apply to indexed life insurance policies and the status of such policies under federal securities laws will continue to be a facts and circumstances determination. However, the Release further states that the considerations that form the basis for Rule 151A are also relevant in analyzing indexed life insurance because indexed life insurance and indexed annuities share certain features, such as securities-linked returns.

The 2nd prong of the test remained the same, that is, the amounts payable under the contract are more likely than not to exceed the amounts guaranteed under the contract.

The Release explains that the amounts payable will be more likely than not to exceed the amounts guaranteed if this is the expected outcome more than half the time. To make this determination, issuers will have to analyze expected outcomes under various scenarios involving different facts and circumstances, including the relevant index, participation rate and features of the contract, particular options selected by the purchaser, the performance of the relevant index, and assumed purchaser behavior.

Under the Rule as adopted, both amounts payable and amounts guaranteed are to be determined by taking into account all charges. This represents another modification in response to comments since the rule as originally proposed would have required surrender charges to be included in determining amounts payable, but not when determining amounts guaranteed.

The rule is “principles-based” and the insurer’s determination of amounts payable and guaranteed would be conclusive provided the methodology, assumptions and computations made by the insurer are reasonable. In order to be conclusive, the determination must be made no earlier than six months prior to the date on which the form of contract is first offered. The proposed requirement that the determination be made not more than three years prior to the date on which a particular contract is issued was eliminated.

The new rule is prospective and will apply to contracts issued after January 12, 2011. The Release explains that for an indexed annuity contract issued to a particular purchaser prior to January 12, 2011, the contract is not subject to Rule 151A, and its status under the federal securities laws is to be determined under the law as it existed without reference to 151A. However, for a contract issued to a particular purchaser after January 12, 2011, the contract is subject to 151A, even if the same form of indexed annuity was offered and sold prior to January 12, 2011.

The SEC states that during this transition period, it intends to consider how to tailor disclosure requirements for indexed annuities and will consider requests for additional guidance.

In addition to requiring registration of indexed annuity contracts, the Rule will also significantly impact the manner in which indexed annuities are sold, since a distributor will now either have to be registered as a broker-dealer, or enter into a networking arrangement with a registered broker-dealer. The Release states that insurance agencies may enter into networking arrangements with both affiliated and unaffiliated broker-dealers.