

Committee of Annuity Insurers
Sutherland Asbill & Brennan LLP
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NAIC SEC Considerations (E) Subgroup: Presentation on Federal Securities Laws and Insurance Company Receiverships

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Federal Securities Laws and Variable Insurance Products

- The SEC:

 - Not a solvency regulator for insurance companies

 - Not a receiver

- Registered Variable Products in Insulated Separate Accounts

 - The Variable Annuity contract (“VA”) or Variable Life Insurance policy (“VLI”) is a security that must be registered under the 1933 Act

 - 1933 Act – Disclosure.** Unless exempted, a financial product that is a security must be registered with the SEC on a registration statement in accordance with the provisions of the 1933 Act – and must be offered to the public by means of a prospectus that is filed as part of the registration statement

Two kinds of insulated Separate Accounts are used to fund VA and VLI products

Managed Separate Account – original VA and VLI funding vehicle

Separate Account is a “management” investment company (same as mutual funds)

Has an investment adviser that manages the assets per the 1940 Act and a board of directors

Originally had only one bucket of securities

Unit Investment Trust (“UIT”)

Registered with the SEC on Form N-4

Insurance company acts as “depositor” for the UIT

No board of directors

Registered Variable Annuities and Variable Life

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- 1933 Act

In order to sell a registered VA/VLI, the insurance company



- 1933 Act (cont'd)

SEC and purchasers can bring injunctive and enforcement actions against company, officers and directors for violating the federal securities laws (Section 20 of 1933 Act)

Willful violations can lead to imprisonment and fines (Section 24 of 1933 Act)

Civil class action and SEC enforcement actions can be brought against the company, its directors, its officers who sign the registration statement, the principal underwriter, and those who “expertize” the registration statement if:

- Prospectus contains materially misleading statements or

- Prospectus fails to state a material fact (Section 11 of 1933 Act)

“Controlling Persons” and “aiders & abettors” also liable (Section 15 of 1933 Act)

- 1940 Act and UIT Separate Accounts

- Daily Valuation of Units of the Separate Account

- Pass-through performance of underlying mutual funds in which the Separate Account invests

- Forward pricing

- Deduct insurance charge from daily unit value

- Daily Redeemability

- Units must be redeemable at daily price

- Payout within seven days

- Highly liquid and transparent

- Separate Account Insulation

- Audited GAAP financial statements for the Separate Account

- Detailed record keeping requirements

- 1940 Act and UIT Separate Accounts (cont'd)

Registration Statement Required

Combined with 1933 Act Registration Statement

Chief Compliance Officer (CCO) Must Be Appointed

Separate Account must have written compliance policies and procedures

CCO must conduct annual review and prepare annual report of adequacy of compliance policies and procedures

SEC Enforcement Powers

SEC has authority to enforce 1940 Act through investigations, subpoenas, injunctions, penalties (Section 42 of 1940 Act)

SEC Enforcement Powers (cont'd)

Contract that violates the 1940 Act is unenforceable
(Section 47 of 1940 Act)

“Controlling Person” and “aiders and abettors” and indirect violations (causing another person to violate) are also covered (Section 48 of the 1940 Act)

- Registered Fixed and Fixed Indexed Annuities: 1933 Act Registration Only

Outside the Section 3(a)(8) exclusion/ Rule 151 because these products expose the contract owner to investment risk

The Insurance Company must register these securities under the 1933 Act on Form S-1 or S-3

- Extensive disclosure about the product, the insurance company and its officers and directors

- Anti-fraud liability

May or may not be funded through an unregistered Separate Account

- Separate Account's investment experience does not pass-through directly into contract value

- Separate Account may or may not be insulated

 - Separate Account insulation varies according to state law

 - Separate Account insulation, alone, does not trigger 1940 Act registration

May have registered fixed and registered variable annuity in same product

Exemptions and Exclusions from 1933 Act and 1940 Act Registration

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- 1933 Act and 1940 Act provide for the exemption of certain securities from SEC registration
 - Certain variable products sold in the pension market
 - COLI/BOLI
 - Subject to the anti-fraud provisions of the federal securities laws
- Private placement VA and VLI products
 - Sold to institutions and high net worth individuals
 - No registration statements is filed with the SEC
 - Not offered using a prospectus
 - Subject to the anti-fraud provisions of the federal securities law
- Exclusion for fixed annuities and life insurance from federal securities laws (Section 3(a)(8), Rule 151, Harkin Amendment)
- Combination Contracts: Partly registered, partly excluded

The SEC's Role in Prior Receiverships

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- The SEC has generally not interceded in insurance company receiverships

State notices and opinion letters and receivership orders have generally recognized the insulation of registered Separate Accounts and redeemability requirements

Mutual Benefit Life Insurance Company (July 1991)



Potential Limits on What a Receiver Can and Cannot Do

- Receiver stands in the shoes of the insurance company and becomes the “control person” of the insurance company managing registered insurance products
- If the product is a registered VA/VLI, receiver should comply with requirements of the 1940 Act

Daily valuation of Separate Account assets

Redeemability of Separate Account assets as required by the 1940 Act

SEC can issue orders suspending redemption

Preserve Separate Account insulation

- If product is registered under the 1933 Act, the receiver must maintain the registration statements
- Receiver’s potential 1933 Act and 1940 Act liability

Ongoing 1933 Act and 1940 Act Considerations

- Receiver's role in:

- Ongoing "evergreening" of prospectuses

- Send prospectus to current investors each year

- Deliver underlying fund documents for Variable Contracts

- Filing updated registration statements

- Auditor opinions and consents

- Filing disclosure about receivership

- Filing disclosure about contract changes

- Restricting premiums

- Distribution changes

- Interest rate changes

- Redeemability

