

VARIABLE ANNUITY CONTRACTS UNDER STATE STATUTES RELATING TO SECURITIES AND TO INSURANCE

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FOREWORD

This report was written in response to Senate Concurrent Resolution No. 55, adopted by the Legislature during the Regular Session of 2006. The concurrent resolution requests the Bureau to examine how other states, such as Indiana, are addressing the issue of reclassifying a variable annuity contract as insurance rather than as a security. The Bureau wishes to acknowledge the invaluable assistance and cooperation of both the Business Registration Division and the Insurance Division, of the Department of Commerce and Consumer Affairs. The Bureau also acknowledges the assistance of the American Council of Life Insurers.

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FACT SHEET

Q: What is a variable annuity contract?

A: The variable annuity contract is a hybrid investment containing both securities and insurance features. The securities feature of variable annuities provides the investor with an opportunity to participate in potential capital appreciation and income through investments in the securities markets. However, the securities feature also subjects the investor to market risks. The insurance feature of variable annuities permits the investor to receive a series of periodic payments from the investment over time. It also provides a death benefit to the beneficiary if the investor dies during the accumulation phase and the account value is less than the "basis" (principal plus gains) at the time of death.

Q: Are variable annuity contracts susceptible to sales practice abuses?

A: Yes. Sales practice abuses associated with variable annuity contracts include churning, failures to make disclosures, inadequate training, lack of supervision, living trust mills, market timing schemes, unauthorized trades, unsuitable variable product recommendations, unsuitable switching or replacement, and violations of books and records requirements.

Some abuses involve the principle of suitability, under which a broker-dealer who recommends a variable product to a customer must assess the customer's financial status, investment objectives, and other relevant information to determine if the product is suitable to the customer. The obligation to recommend only securities that are suitable for the investor arises from the antifraud provisions of the federal securities laws and from rules of the self-regulatory organizations. A broker-dealer must have a reasonable basis for believing that the securities recommendations are suitable for the customer in light of the customer's financial needs, objectives, and circumstances.

Q: Who regulates variable annuity contracts in Hawaii?

A: Both the securities commissioner and the insurance commissioner have concurrent jurisdiction over variable annuity contracts and the persons involved in their issuance and sale. Specifically, the insurance commissioner oversees insurers, the contract itself, and salespersons. The securities commissioner oversees broker-dealers, salespersons, and sales practice abuses. There is concurrent enforcement over salespersons. Between the two, the suitability issues are evidently the realm of securities, not insurance.

Q: What are the statutory bases for the two commissioners' authority over variable annuity contracts?

A: The securities commissioner's authority is based on the definition of "security" in the uniform securities act. The definition expressly includes a "variable annuity contract." Defining a "security" to include a "variable annuity contract" gives the securities commissioner jurisdiction over sales practice abuses relating to variable annuity contracts. The insurance commissioner's authority is based on the variable contract law in the insurance code. The law has an exclusive jurisdiction provision that expressly gives the insurance commissioner the sole and exclusive authority over the issuance and sale of variable contracts, including the licensing of persons selling variable contracts, notwithstanding any other provision of law. Variable annuity contracts are a type of variable contract.

Q: Are the statutes inconsistent with each other?

A: On the surface, they appear to be, due to that exclusive jurisdiction language. However, in practice, the insurance commissioner's jurisdiction is not exclusive. Jurisdiction is shared with the securities commissioner.

Q: Do other states have securities acts and variable contract laws?

A: Yes. All states have securities acts. All states have variable contract laws in their insurance codes or insurance statutes.

Q: Are the securities acts and variable contract laws in other states likewise jointly applicable to variable annuity contracts?

A: No. While the variable contract laws in all states are applicable to variable annuity contracts, the securities acts in most states are not applicable to variable annuity contracts. Specifically, the securities acts in thirty-six states do not appear to apply to variable annuity contracts. The securities acts in the remaining fourteen states do appear to apply to variable annuity contracts.

Q: Do other states have the exclusion jurisdiction language in their variable contracts laws?

A: Yes, most states do. Forty states have them. Ten states do not. Also, in some of those forty states, the exclusive jurisdiction provision specifies that the authority is granted to the insurance commissioner notwithstanding any other law. In some, the provision even specifies that the contracts and sellers are not subject to the securities act or to the securities commissioner.

Q: Are there any federal mandates that require a state's securities act to apply to a variable annuity contract, or prohibit a state's securities act from applying to a variable annuity contract?

A: No. However, the federal Securities Act of 1933 has been construed by the United States Supreme Court to include variable annuity contracts as securities.

Q: Should Hawaii's securities act be consistent and uniform with the federal Securities Act of 1933, by retaining the present definition of "security" in which a variable annuity contract is expressly a security, or should the act be consistent and uniform with the securities acts of the majority of states, by amending the definition of "security" so that a variable annuity contract is excluded from being a security?

A: That would appear to be a policy choice.

Q: Is there anything that can be done to clarify the present status quo in which the securities commissioner and the insurance commissioner have concurrent jurisdiction over variable annuity contracts?

A: Yes, the Legislature could repeal the exclusive jurisdiction language in the variable contracts law. Alternatively, the Legislature could amend the exclusive jurisdiction language so as to specify that the securities act is applicable to variable contracts.

Q: Do any other states have clarifying language like that in the exclusive jurisdiction provision of their variable contract law?

A: Yes, Montana does. The exclusive jurisdiction provision in the Montana variable contract law specifies that, *except as provided in the securities act*, the insurance commissioner has sole authority to regulate the issuance and sale of variable contracts.

Q: How about Indiana?

A: Indiana has a securities act that excludes variable annuity contracts as securities. It has a variable contract law that does not contain the exclusive jurisdiction provision. The current structure of Indiana's law is untested, as there have been no variable annuity cases in the past couple of years. The securities commissioner believes that it is suboptimal. The department of insurance states that there seems to be some overlapping responsibilities and authority between the department and the securities division, but that both agencies work cooperatively with each other, and there are no problems caused by this arrangement.

Chapter 1

INTRODUCTION

Senate Concurrent Resolution No. 55 was adopted by the Legislature during the regular session of 2006. It requests the Legislative Reference Bureau to examine how other states, such as Indiana, are addressing the issue of reclassifying a variable annuity contract as insurance rather than as a security. (See Appendix A.)

We interpret the request to cover the present classification of variable annuity contracts under state insurance codes and securities acts. We will therefore ascertain whether other states' insurance codes presently apply to variable annuity contracts and whether other states' securities acts presently apply to variable annuity contracts.

We note that variable annuity contracts are a hybrid financial product. They contain features characteristic of both insurance and securities. Accordingly, they may be subject to regulation under both the insurance codes and the securities acts for the different purposes underlying the insurance codes and the securities acts.

The request for this study is evidently prompted by media reports of the widespread sales practice abuses associated with variable annuity contracts. The resolution mentions that there has been widespread negative publicity and concerns over the overzealous marketing and inappropriate sales of variable annuity contracts to consumers, in particular senior consumers and consumers approaching retirement. In particular, securities regulators have brought actions for sales practice abuses including misleading advertising, unsuitable recommendations, switching and churning of customer accounts to increase sales commissions, and the failure to disclose fees and other important characteristics of these contracts.

Accordingly, we furthermore interpret the request of the resolution to address the relevance of classification to sales practice abuses.

The insurance statutes of all fifty states are applicable to variable annuity contracts. Specifically, they all have a variable contracts law that applies to variable annuity contracts. Also, most of these variable contract laws give the insurance commissioner the sole or exclusive authority over the sale and issuance of variable annuity contracts. Some also specify whether the insurance statutes preempt or preserve the applicability of the securities acts to variable annuity contracts.

In contrast, the securities acts of the fifty states may or may not be applicable to variable annuity contracts. The securities acts in the majority of states are not applicable to them. The securities acts in a minority of states are applicable to them.

In answer to the legislative request, the primary issue in the classification of variable annuity contracts under state securities and insurance statutes is whether a state's securities act

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applies to variable annuity contracts. A secondary issue, where applicable, is whether that state's insurance statutes contain the exclusive jurisdiction language.

Our findings are set forth in the following chapters.

Chapter 2 discusses the relevance of the classification of variable annuity contracts to jurisdiction over sales practice abuses, the sales practice abuses associated with variable annuity contracts, and the hybrid nature of variable annuity contracts.

Chapter 3 discusses variable annuity contracts under federal securities and insurance legislation.

Chapter 4 discusses the classification of variable annuity contracts under Hawaii law, specifically, the securities acts and the insurance code.

Chapters 5 and 6 respectively cover the classification of variable annuity contracts under the securities acts and the insurance codes of the fifty states. Research on other states' statutes was done over the internet and reflects statutes that were online during the summer and early fall of 2006.

Chapter 7 does a side-by-side contrast of each state's insurance and securities statutes with regard to the issue of exclusive insurance regulation and its resolution.

Chapter 8 briefly discusses other similar studies on classification done in the past by others.

Chapter 9 summarizes the findings of this report.

A glossary of terms is included in the appendix.

Chapter 2

VARIABLE ANNUITY CONTRACTS

The Variable Annuity Contract

A variable annuity contract is a contract between a purchaser and an insurer. The purchaser makes either a single purchase payment or a series of purchase payments. The insurer agrees to make periodic payments to the purchaser beginning either immediately or at some future date. The contract offers investment options, which are typically mutual funds. Money may be transferred from one investment option to another within the annuity without paying a tax at the time of the transfer. Furthermore, no taxes are paid on the income and investment gains from the annuity until money is withdrawn. Earnings are then taxed at ordinary income tax rates and not the lower capital gains rates.

The contract has two phases: an accumulation phase and a payout phase. During the accumulation phase, the purchaser allocates purchase payments among the investment options. Payments are not guaranteed as they are dependent upon the performance of the underlying investments. During the payout phase, the purchaser receives the purchase payments plus investment income and gains either as a single lump sum or through a stream of payments made at regular intervals for a definite or an indefinite period. The payments are either fixed in amount or vary based on the performance of the investment options. Some annuities do not allow the purchaser to withdraw money from the account once regular annuity payments have commenced.

A common feature of the contract is the death benefit. The amount of the benefit is the greater of the account value or some guaranteed amount, such as all purchase payments less prior withdrawals. The benefit is payable to the specified beneficiary if the purchaser dies before the payout phase has begun. The beneficiary will get a benefit if the account value is less than the guaranteed amount.

The contract also has fees and charges, such as surrender charges, mortality and expense risk charges, administrative fees, and underlying fund expenses. The surrender charge in particular is an assessment against withdrawals of money from a variable annuity within a certain period of time after a purchase payment. It is generally a percentage of the amount withdrawn, and declines gradually over a period of years, known as the "surrender period."¹

Conceptually, the variable annuity is a hybrid investment containing both securities and insurance features. The securities feature of variable annuities provides the investor with an opportunity to participate in potential capital appreciation and income through investments in the securities markets. However, the securities feature also subjects the investor to market risks. The insurance feature of variable annuities permits the investor to receive a series of periodic

¹ "Variable Annuities: What You Should Know", last modified January 27, 2006, Online Publications for Investors, U.S. Securities and Exchange Commission, at <http://www.sec.gov>.

payments from the investment over time. It also provides a death benefit to the beneficiary if the investor dies during the accumulation phase and the account value is less than the "basis" (principal plus gains) at the time of death.²

Additionally, the variable annuity differs from the more traditional fixed annuity in the way that the investor or customer's money is invested. In a fixed annuity, the investor's money is deposited into the insurance company's general account. The insurance company then determines where the money will be invested. In a variable annuity, on the other hand, the investors are able to select the type of investments and must continuously evaluate the investments and adjust the asset allocations as changes occur in their investment profile, horizon and risk tolerance, as well as changes in the market. An investment professional may be needed to ensure that necessary corrections are being made to meet the investor's goals. Investors are accordingly susceptible to various securities violations.³

Also, it has been reported that sales-related problems of variable annuity contracts parallel those of mutual funds and other securities. According to the National Association of Securities Dealers:

Based on our experience, we have found that variable contracts sales-related problems parallel those of mutual funds and other securities. These problems include, among other things, misleading advertising, unsuitable recommendations, switching and churning of customer accounts to increase sales commissions, and the failure to disclose fees and other important characteristics of these contracts. Because of the substantial similarities between variable contracts and other securities products, we believe it is incongruous for agents and sales practices involved in variable contracts not to be covered by state securities laws.⁴

Sales Practice Abuses Relating to Variable Annuity Contracts

As indicated in S.C.R. No. 55, the impetus for a study on the classification of variable annuity contracts under state securities and insurance laws is concern over sales practice abuses surrounding the sale of variable annuity contracts to seniors. These sales tactics are used to convince older investors to purchase a variable annuity when it is clearly unsuitable to their circumstances. The sales scenario may go like this:

The older investor, who may be concerned about making sure that his money will stretch to cover medical or care expenses, gets an invitation to a free dinner at a retirement planning seminar. The session is solely a promotion platform where the merits of variable annuities are exalted. If the diner seems interested and slips into releasing a phone number, a salesman will soon show up on his doorstep. The salesman will demand to inspect bank accounts and broker statements and the hard sales pitch will continue

² "Variable Annuities--Facts and Fiction", February 2005, North American Securities Administrators Association.

³ Correspondence from the Department of Commerce and Consumer Affairs, Business Registration Division, to the Legislative Reference Bureau, October 6, 2006, in response to questions submitted by the Bureau.

⁴ Variable Annuities--Facts and Fiction, February 2005, North American Securities Administrators, page 2, quoting a letter of support from the Vice Chairman and President of Regulatory Policy and Oversight, of the National Association of Securities Dealers.

often for hours until the investor is worn down and signs just to get rid of the salesman. Despite the lengthy pitches, the investor is sold a complex investment product he does not understand, is not told that annuities award the salesman some of the highest commissions in the investment business, and doesn't realize that his money is tied up for years and unavailable for any emergencies without steep withdrawal penalties.⁵

As a general matter, sales practice abuses relating to variable annuity contracts can take many different forms. The principle of suitability appears to be at the core of quite a few of them. According to the securities commissioner, the principle of suitability requires that a broker-dealer recommending a variable product to an investor must assess the investor's financial status, investment objectives, and other relevant information to determine if the product is suitable. The obligation to recommend only securities that are suitable for the customer arises from the antifraud provisions of the federal securities laws and from rules of the self-regulatory organizations. A broker-dealer must have a reasonable basis for believing that the securities recommendations are suitable for the customer in light of the customer's financial needs, objectives, and circumstances.⁶ The following, provided by the securities commissioner, is a list of some of the kinds of sales practice abuses that have occurred with variable annuity contracts.⁷ (The scenario described in the quote above is an example of the living trust mill)

Churning. Churning occurs when an agent uses misrepresentation or unfair and deceptive sales practices to convince a consumer to replace an existing policy with a new policy, whether issued by the same or a different company, and to do this over and over. Such repeated activity generates new business commissions that are substantially higher than renewal commissions. Churning usually benefits the salesperson, not the consumer. Changing contracts is costly. In addition to paying a surrender charge when surrendering the existing policy, the consumer also may be charged a sales fee, which is deducted from the initial premium paid under the new contract. Additionally, the consumer may lose a bonus credit under the existing contract.

Failure to make disclosures. Failure to make disclosures includes failure to disclose fees, risks, lack of liquidity of variable products, guaranteed death benefit, tax implications, and potential consequences of financing a variable product.

Inadequate training. Inadequate training of registered representatives and supervisors by broker dealers over the sale of variable products results in supervisors not being sufficiently trained or experienced enough to identify abusive sales practices when they review variable transactions.

⁵ "Interview with Marie F. Smith, President of AARP: Protecting our 'Wise Elders' from Fraud", by Dick Carozza, *Fraud Magazine*, pp. 37-44, (undated).

⁶ Correspondence from the Department of Commerce and Consumer Affairs, Business Registration Division, October 12 and 13, 2006, to inquiries from the Bureau, October 12, 2006.

⁷ Correspondence from the Department of Commerce and Consumer Affairs, Business Registration Division, October 12 and 13, 2006, to inquiries from the Bureau, October 12, 2006.

Lack of supervision. Lack of supervision includes inadequate written supervisory procedures, supervisory failures, failure to place registered representatives on heightened supervision after indications of abusive sales practices, documentation failures, and system failures.

Living trust mills. Living trust mills are a type of scam that often targets seniors. Many times they take on the form of a “free” seminar on living trusts in which a sales agent poses as an estate planner or financial expert. The agent will then try to schedule a visit to the senior’s home to gather and review information on the senior’s assets and investments. Usually, the sales agent then schedules a second visit to deliver a completed trust and to have documents signed and notarized, and title of assets transferred to the trust. The agent scares the senior into believing the senior's present investments are unsafe, and that by "moving" the senior's money, the money can earn higher interest with no risk. Just to generate a commission, the agent has the senior sign documents that transfer the senior's CD, mutual fund accounts, or other investments to an annuity regardless of whether the annuity would be suitable or not.

Market timing schemes. Market timing schemes involve the quick trading of mutual fund shares or variable annuity subaccounts between the time the fund price is locked in after markets close and the time the shares or subaccounts begin trading when the markets next open. Deceptive market timing in variable annuity subaccounts can dilute the value of those shares, raise transaction costs, and thus harm other annuity investors.

Unauthorized trades. Unauthorized trades occur when a broker buys or sells a variable annuity without having discretionary authority to buy or sell or without first obtaining a client’s prior approval to buy or sell. Unauthorized trades can also occur in a variable annuity where the broker switched subaccounts of a variable annuity without the clients’ prior approval.

Unsuitable variable product recommendations. Unsuitable variable product recommendations are made when the broker has no reasonable basis to make the recommendation considering the customer's age, financial or tax status, investment objectives, investment sophistication, low risk tolerance, need for liquidity, lack of need for life insurance, and other relevant information. Specific examples may include:

- Sales of a variable product that require the mortgage of a home to finance the purchase;
- Sales that require a customer to borrow from an existing life insurance policy or annuity;
or
- Sales of an illiquid variable product to persons who need their funds soon and as a result will incur surrender charges to obtain their funds.

Unsuitable switching or replacement. Unsuitable switching or replacement occurs when registered representatives give unfounded, false, or misleading justifications for switches or replacements, or misrepresent or fail to inform clients of sales charges associated with switches or replacements. Excessive switching of variable annuities may occur when the switches take place in customer accounts on a periodic basis once every two to three years.

Violations of books and records requirements. Violations of books and records requirements under the rules of the federal Securities Exchange Act of 1934 make it difficult to determine whether a broker-dealers' recommendations to customers were suitable.

The Relevance of Statutory Classification to Sales Practice Abuses

Although sales practice abuses is the impetus for this study on classification, it should be pointed out at the start that classifying a variable annuity contract as a security under the securities act or as insurance under the insurance code is not the same thing as regulating the sales practice abuses that surround the contract. Classification of the contract and regulation of sales practice abuses surrounding the contract are two separate, but related matters. The relationship can be stated as follows. Classifying a variable annuity contract as a security under the securities act grants the securities commissioner the authority to regulate sales practice abuses surrounding the variable annuity contract. Classifying a variable annuity contract as only insurance under the insurance code opens up a gap in the regulation of those sales practice abuses.

Both the insurance commissioner and the securities commissioner in Hawaii support the status quo, which means continuing to have variable annuity contracts regulated both as insurance and as securities under the insurance code and the securities act, respectively. In particular, both support the present framework of having the regulation of sales practice abuses remain with the securities commissioner. The reasons involve subject matter expertise, inter-agency working relationships, and the prevention of gaps in enforcement.

The insurance commissioner points out that, as a practical matter, debating the classification of variable annuity contracts will not solve the consumer protection concerns. The more important issue is identifying the entity that has the expertise to regulate the various hybrid aspects of a variable annuity. Since variable annuity contracts have both insurance and securities aspects, the protection of the public interest requires that these annuities be regulated by both the insurance commissioner and the securities commissioner.⁸

In particular, the insurance commissioner states that removing the authority of the securities commissioner over variable annuities is not the solution to resolving the suitability issues. Suitability relates to the duty of the broker to recommend to a customer only those securities that are suitable to the investment objectives and peculiar needs of that particular customer. "Suitability issues are clearly in the realm of securities, not insurance."⁹

Furthermore, the insurance commissioner advises that the securities commissioner has an established working relationship with national-level securities regulators, specifically, the federal Securities and Exchange Commission and the self-regulatory organization, the National

⁸ Correspondence from the Department of Commerce and Consumer Affairs, Insurance Division, to the Legislative Reference Bureau, October 19, 2006, in response to questions submitted by the Bureau.

⁹ Correspondence from the Department of Commerce and Consumer Affairs, Insurance Division, to the Legislative Reference Bureau, October 19, 2006, in response to questions submitted by the Bureau.

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Association of Securities Dealers. The insurance commissioner, on the other hand, does not have a relationship with either the Securities and Exchange Commission or the National Association of Securities Dealers.¹⁰

Likewise, the securities commissioner, in turn, states that its office has the expertise in detecting and deterring sales practice violations, such as misleading advertising unsuitable recommendations, switching and churning of customer accounts to increase sales commissions, the failure to disclose fees and other important characteristics of variable annuity contracts, and failure to supervise. In contrast, the insurance commissioner does not currently investigate variable annuity contract sales practice abuse complaints. Instead, all such cases are referred to the securities commissioner, and the two divisions work in concert to respond to abuses related to variable annuity sales. The responsibilities of the insurance commissioner and the securities commissioner are clearly delineated and, further, both the securities commissioner and the insurance commissioner are in the same department and the activities of the agencies are well coordinated.¹¹

The securities commissioner provided Table 1 below to illustrate the respective jurisdictions of the securities commissioner and the insurance commissioner over variable annuity contracts themselves, the issuers of the contracts, and the sellers of the contracts.¹²

Table 1. State of Hawaii Variable Annuities Enforcement

Jurisdiction	State of Hawaii Insurance Commissioner	State of Hawaii Securities Commissioner
Insurance Company	X	
Variable Annuity Contract	X	
Broker-dealer		X
Salesperson	X	X
Sales Practice Abuses		X

As the table indicates, the insurance commissioner and the securities commissioner have their respective jurisdictions over the product, the issuers, the persons involved in the sale of the product, and sales practices. Specifically, the insurance commissioner regulates the insurers, the contract itself, and salespersons. The securities commissioner regulates the broker-dealers, the salespersons, and sales practice abuses. There are presently no gaps in enforcement. There is concurrent enforcement over salespersons.

Accordingly, removing the securities commissioner's present jurisdiction over variable annuities will create in gaps in enforcement. Specifically, there will be gaps in enforcement over broker-dealers and sales practice abuses, and only a single layer of jurisdiction would remain with regard to salespersons.

¹⁰ Correspondence from the Department of Commerce and Consumer Affairs, Insurance Division, to the Legislative Reference Bureau, October 19, 2006, in response to questions submitted by the Bureau.

¹¹ Correspondence from the Department of Commerce and Consumer Affairs, Business Registration Division, to the Legislative Reference Bureau, October 6, 2006, in response to questions submitted by the Bureau.

¹² Letter to the Legislative Reference Bureau, dated September 29, 2006, from the State of Hawaii Department of Commerce and Consumer Affairs, Business Registration Division.

As an example of the gaps in enforcement that would occur if the securities commissioner loses regulatory authority over variable annuities, the securities commissioner points to the recently concluded case involving the financial services group, Waddell & Reed, Inc. Waddell & Reed was alleged to have engaged in a deliberate campaign, motivated by its own business interests and not those of its clients, to switch customers from one variable annuity to another annuity product in order to generate commissions for its sales force. Switching violates two fundamental principles under which every firm must operate in every securities transaction. These principles are placing the client's interests first and assessing the suitability of any recommendation.

Waddell & Reed is a broker-dealer. It is neither an insurer nor an insurance producer. Accordingly, had variable annuities been outside the scope of the securities act, Waddell & Reed's actions would have fallen through the gaps. Its actions would not have been subject to oversight under the insurance code.

Secondly, and hypothetically, if Waddell & Reed actually had been an insurance producer and its actions subject to oversight under the insurance code, its actions nonetheless would not have been adequately addressed. The insurance code, unlike the securities act, lacks the necessary language to allow the insurance commissioner to address Waddell & Reed's actions, specifically, the unsuitable recommendations, the switching and churning of customer accounts to increase sales, the lack of supervision of such sales, the failure to disclose fees, and the engaging in dishonest and unethical practices.

Third, the remedies available under the securities act and the insurance code are very different. Restitution to customers is available under the securities act, not the insurance code. Fines are higher under the securities act. Criminal penalties are also greater under the securities act.¹³

Finally, an organization that is not in support of the status quo, under which the securities act is applicable to variable annuity contracts, is the American Council of Life Insurers. Their position with regard to the classification of variable annuity contracts is that the contracts should be regulated only under the insurance code and not under the securities act. Specifically, they support the exclusion of variable annuity contracts from the scope of the securities act.¹⁴ Instead, they support amendments to the insurance code that would add provisions aimed at protecting senior consumers in annuity transactions. The legislation that they propose is based on recent Indiana legislation that is, in turn, an abridged version of the Senior Protection in Annuity Transactions Model Regulation that was drafted by the National Association of Insurance Commissioners.¹⁵

¹³ Correspondence from the Department of Commerce and Consumer Affairs, Business Registration Division, to the Legislative Reference Bureau, October 6, 2006, in response to questions submitted by the Bureau.

¹⁴ Statement to the National Conference of State Legislatures, Life Insurers' Position on the Uniform Securities Act, December 9, 2004, American Council of Life Insurers.

¹⁵ Correspondence from the American Council of Life Insurers, October 3, 2006, in response to inquiries from the Bureau. The American Council of Life Insurers provided the Bureau with a copy of Senate Enrolled Act No. 634 from the first regular session of the 114th Indiana General Assembly (2005). The provisions of this legislation that specifically pertain to recommendations to senior consumers have been codified as a new chapter at Indiana Code

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Under the Indiana legislation, an insurance producer may not recommend to a senior consumer either the purchase of an annuity or the exchange of an annuity resulting in another insurance transaction if the purchase or exchange is unsuitable for the senior consumer. Suitability turns upon facts disclosed by the senior consumer concerning the senior consumer's investment and other insurance products and financial situation and needs. Unsuitable recommendations constitute an unfair method of competition or an unfair and deceptive act or practice. Investigative and enforcement powers rest with the insurance commissioner. If the annuity is a variable annuity, the insurance commissioner may consult with the securities commissioner and also use the resources of the securities commissioner in determining unsuitability.

According to the American Council of Life Insurers, the Indiana legislation "relate to a very effective solution supported by life insurers and the Indiana Securities Administrator....This approach would work well in Hawaii, and have the strong support of the life insurance industry."¹⁶

In effect, the council supports a transfer of jurisdiction from the securities commissioner to the insurance commissioner. However, under the council's proposal, some jurisdiction is lost in the transfer. The insurance commissioner end ups with less than what the securities commissioner lost. The reason is that the proposed legislation covers only unsuitable recommendations to seniors. It does not cover unsuitable recommendations to customers in general. In turn, the sales practice abuses relating to unsuitable recommendations constitute only a fraction of sales practice abuses in general. Accordingly, unsuitable recommendations to seniors constitute only a fraction of sales practice abuses in general.

Referring back to the table above on variable annuities enforcement, the council's proposal would result in the removal of an "X" from the box that signifies the securities commissioner's jurisdiction over sales practice abuses and the placement of only that portion of the "X" that represents suitability issues into the box that signifies the insurance commissioner's jurisdiction over sales practice abuses. Thus, the council's position, if put into effect in Hawaii, would produce a gap in enforcement over the sales of variable annuity contracts.

sections 27-4-9-1 to 27-4-9-6. The chapter is entitled "Recommendations to Senior Consumers." It is based on the Senior Protection in Annuity Transactions Model Regulation that was developed by the National Association of Insurance Commissioners. According to the National Association of Insurance Commissioners, these Indiana Code sections include a portion of the model and the authority to adopt regulation. See, NAIC Model Regulation Service--January 2006, on the Senior Protection in Annuity Transactions Model Regulation.

¹⁶ Correspondence from the American Council of Life Insurers, October 6, 2006.

Chapter 3

VARIABLE ANNUITY CONTRACTS UNDER FEDERAL LAW

Introduction

This chapter briefly discusses federal securities and insurance laws relating to the classification of variable annuity contracts. Its main purpose is to indicate that the federal classification of variable annuity contracts under federal securities laws is not binding on the states. It also suggests that defining a variable annuity contract as a security under a state securities act is consistent with the inclusion of variable annuity contracts as securities under the federal Securities Act of 1933.

Findings

Under the federal Securities Act of 1933, variable annuity contracts are deemed to be securities, and not to be insurance. A variable annuity contract is a security, and because it does not fall within the registration exemption for insurance and annuity contracts, it must be registered with the Securities and Exchange Commission, according to the United States Supreme Court in its 1959 opinion, *S.E.C. v. Variable Annuity Co.*, 359 U.S. 65 (1959). The holding remains valid to the present.

The case involved life insurance companies regulated under the insurance laws of the District of Columbia and several other states. The Securities and Exchange Commission sought to enjoin these companies from offering their variable annuity contracts to the public unless these companies registered those variable annuity contracts under the Securities Act of 1933.¹

The federal Securities Act of 1933 prohibits any person from selling any "security" in interstate commerce unless the person registers the security with the Securities and Exchange Commission.² The act's definition of a "security," both then and now, does not expressly include variable annuity contracts.³ The Court, however, interpreted the definition of "security" to be broad enough to include any "annuity contract," including a variable annuity contract.

A second issue involved interpreting the exemption from registration for a security that is "insurance" or an "annuity contract" subject to supervision by a state insurance commissioner.⁴ A security that is exempt from registration is still a security under the Act, and the rest of the Act apart from registration applies to it. The Court interpreted the registration exemption for annuity contracts as not being applicable to the variable annuity contract. Therefore, the Court held that, under the act, variable annuity contracts must be registered the commission.

¹ 15 U.S.C. sections 77a et al.

² 15 U.S.C. section 77e (a).

³ 15 U.S.C. section 77b (a)(1).

⁴ 15 U.S.C. section 77c (a)(8).

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In reaching its ultimate holding that the life insurance companies were required to register their variable annuities with the commission, the Court had to preliminarily hold that a variable annuity contract was not "insurance" under federal statutes where the words "insurance" and "annuity" are federal terms. These federal statutes were the Securities Act of 1933,⁵ the Investment Company Act,⁶ and the McCarran-Ferguson Act.⁷ In the words of the Court:

[A]bsent some guarantee of fixed income, the variable annuity places all the investment risks on the annuitant, none on the company. The holder gets only a pro rata share of what the portfolio of equity interests reflects--which may be a lot, a little, or nothing....But we conclude that the concept of "insurance" involves some investment risk-taking on the part of the company. The risk of mortality, assumed here, gives these variable annuities an aspect of insurance. Yet it is apparent, not real; superficial, not substantial. In hard reality the issuer of a variable annuity that has no element of a fixed return assumes no true risk in the insurance sense....The companies that issue these annuities take the risk of failure. But they guarantee nothing to the annuitant except an interest in a portfolio of common stocks or other equities [footnote omitted]--an interest that has a ceiling but no floor.[footnote omitted] There is no true underwriting of risks, [footnote omitted] the one earmark of insurance as it has commonly been conceived of in popular understanding and usage.⁸

The classification of variable annuity contracts as securities under the federal Securities Act of 1933 is not binding on the states. It does not work as a federal mandate on the states. Thus, the states are free to classify the contracts under their own state securities acts as securities or not as securities. Most states have in fact classified them as not being securities under their state securities acts.

Also, the federal Securities Act of 1933 preserves the states' fraud authority. It recognizes each state's authority to "investigate and bring enforcement actions with respect to fraud or deceit, or unlawful conduct by a broker or dealer, in connection with securities or securities transactions."⁹

Finally, there is no federal insurance code for interstate commerce. At the federal level, there is no insurance counterpart to the federal Securities Act of 1933. Instead, there is an insurance-related act known as the McCarran-Ferguson Act,¹⁰ which recognizes that the "business of insurance" shall be regulated by the states. The Act also protects such state regulation from being preempted by federal legislation that is not specifically related to the "business of insurance." Specifically, the federal McCarran-Ferguson Act recognizes the role of state regulation of insurance as follows:

⁵ 15 U.S.C. section 77a et al.

⁶ 15 U.S.C. section 80a-1 et al.

⁷ 15 U.S.C. section 1011 et al.

⁸ S.E.C. v. Variable Annuity Life Insurance Co. of America, 359 U.S. 65, 69-73 (1959).

⁹ 15 U.S.C. section 77r (c) (1).

¹⁰ 15 U.S.C. section 1011 et al.

The business of insurance, and every person engaged therein, shall be subject to the laws of the several States which relate to the regulation or taxation of such business.¹¹

Furthermore, the McCarran-Ferguson Act protects state insurance laws from federal preemption as follows:

No Act of Congress shall be construed to invalidate, impair, or supersede any law enacted by any State for the purpose of regulating the business of insurance, or which imposes a fee or tax upon such business, unless such Act specifically relates to the business of insurance: Provided, That after June 30, 1948, the Act of July 2, 1890, as amended, known as the Sherman Act, and the Act of October 15, 1914, as amended, known as the Clayton Act, and the Act of September 26, 1914, known as the Federal Trade Commission Act, as amended [[15 U.S.C. 41](#) et seq.], shall be applicable to the business of insurance to the extent that such business is not regulated by State Law.¹²

¹¹ 15 U.S.C. section 1012 (a).

¹² 15 U.S.C. section 1012 (b).

Chapter 4

HAWAII LAW

Introduction

This chapter presents an overview of the regulation of variable annuity contracts and the entities involved in their issuance and sale under the securities act and the insurance code of the State of Hawaii. This preliminary knowledge will facilitate a subsequent comparison and contrast with the securities and insurance statutes of the other states.

Findings

In Hawaii, variable annuity contracts are classified as both securities under the securities act and insurance under the variable contract law. The securities act is based upon the Uniform Securities Act (1956), drafted by the National Conference of Commissioners on Uniform State Laws. It primarily regulates sales practices with respect to securities such as variable annuity contracts. The variable contract law, contained within the insurance code, is based upon the model variable contract law, drafted by the National Association of Insurance Commissioners. It primarily regulates the issuance and sale of the variable product.

Under the securities act, a "security" is defined to expressly include a variable annuity contract. Therefore, because a variable annuity contract is a "security," securities salespersons and securities broker dealers who engage in the sale of variable annuity contracts are subject to regulatory oversight by the securities commissioner. Specifically, sales practice abuses concerning variable annuity contracts are under the jurisdiction of the securities commissioner. The act gives the securities commissioner the authority to grant rescission and restitution for consumers for any violation of the act. The act recognizes fraud as a crime punishable as a felony. Although the current act is being replaced on July 1, 2008, with a new securities act, the new act remains applicable to variable annuity contracts.

Concurrently, the variable contract law in the insurance code is also applicable to variable annuity contracts. According to this law, the issuance and sale of variable contracts, and the licensing of persons selling variable contracts, are solely and exclusively under the authority of the insurance commissioner. This sole and exclusive authority is granted to the insurance commissioner, notwithstanding any other provision of law. No specific reference is made to the securities act.¹ The insurance code allows for limited restitution to consumers for replacements. The code recognizes misrepresentation as a crime punishable as a misdemeanor.

The above findings are presented in more detail in the rest of this chapter below.

¹ However, in practice, a person selling a variable annuity is subject to licensing by the National Association of Securities Dealers and any other state securities agency requiring registration. Comments on the preliminary draft of this report, submitted by the Department of Commerce and Consumer Affairs, Business Registration Division, October 16, 2006.

The Uniform Securities Acts

There are presently two versions of the uniform securities acts that can be found among the Hawaii Revised Statutes. One is chapter 485, the Uniform Securities Act (modified). This is the version that is currently in effect. It took effect in 1957,² and it is modeled after the Uniform Securities Act (1956) drafted by the National Conference of Commissioners on Uniform State Laws.³ Reportedly, the Hawaii act is a substantial adoption of the major provisions of the 1956 Uniform Securities Act, but it contains numerous variations, omissions, and additional matter.⁴

The purpose of the present chapter 485, as expressed in its legislative history, is to adequately regulate and control the sale of securities.⁵ Specifically, one purpose is to protect purchasers of securities by making available to them pertinent information concerning the security and the issuer. Another purpose is to enable the commissioner of securities to effectively regulate the sale of securities.⁶

Chapter 485 will be repealed and replaced on July 1, 2008, by chapter 485A, on the Uniform Securities Act (2002),⁷ which is modeled after the Uniform Securities Act (2002) drafted by the National Conference of Commissioners on Uniform State Laws.⁸ The replacement version was signed into law on June 22, 2006,⁹ and the effective date is July 1, 2008.¹⁰ The reason for the two-year delay, as indicated in the legislative history of the 2006 act, is to allow time for rulemaking.¹¹

Aside from being a replacement version of the older law, the underlying purpose of the new chapter 485A, as expressed in its legislative history, remains consumer protection. The purpose is to enhance the ability of the state securities regulator to protect consumers engaged in security transactions¹² and to give the state securities regulator broad powers to investigate, prosecute, and sanction individuals and firms that engage in securities transactions.¹³

² Act 314, Session Laws of Hawaii 1957.

³ Senate Standing Committee Report No. 231 on S.B. No. 419, Senate Journal 1957; House Standing Committee Report No. 931 on S.B. No. 419, House Journal 1957.

⁴ Uniform Securities Act: 1956 Act, General Statutory Note, page 104, Uniform Laws Annotated, Business and Financial Laws.

⁵ Senate Standing Committee Report No. 231 on S.B. No. 419, Senate Journal 1957.

⁶ House Standing Committee Report No. 931 on S.B. No. 419, House Journal 1957.

⁷ Act 229, Session Laws of Hawaii 2006.

⁸ Conference Committee Report No. 31-06 on S.B. No. 743, Regular Session of 2006; House Standing Committee Report No. 1091 on S.B. No. 743, Regular Session of 2005; Senate Standing Committee Report Nos. 694 and 610 on S.B. No. 743, Regular Session of 2005.

⁹ Governor's Message No. 759 on S.B. No. 743 S.D. 2, H.D. 2, C.D. 1, June 22, 2006.

¹⁰ Act 229, section 20, Session Laws of Hawaii 2006.

¹¹ Conference Committee Report No. 31-06 on S.B. No. 743, Regular Session of 2006.

¹² House Standing Committee Report No. 1091 on S.B. No. 743, Regular Session of 2006.

¹³ Senate Standing Committee Report No. 610 on S.B. No. 743, Regular Session of 2005. The measure was carried over to the 2006 session.

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Both chapter 485 and 485A expressly deem variable annuity contracts to be securities. Under present chapter 485:

"Security" means any ... variable annuity contract, ...¹⁴

Likewise, under future chapter 485A:

"Security" means a ... variable annuity contract; ...¹⁵

A direct consequence of defining "security" to include a variable annuity contract under both chapters is to place sales practice abuses related to variable annuity contracts under the oversight of the securities commissioner. For example, under present chapter 485, the securities commissioner has the authority to sanction registrants for a range of conduct, including unworthiness,¹⁶ and to prosecute securities fraud committed by anyone, registrant or otherwise.¹⁷ Violations are punishable as felonies, ranging from class C to class A felonies.¹⁸ The securities commissioner also points out that the act authorizes the commissioner to provide rescission and restitution for consumers in the State of Hawaii for any violation of the act.¹⁹ Under the new chapter 485A, the securities commissioner continues to have comparable powers, specifically, the authority to sanction registrants for a range of conduct, including unworthiness,²⁰ and to prosecute securities fraud committed by anyone, registrant or otherwise.²¹

Finally, one area in which there is a difference between the two chapters involves a registration exemption that is available to dealers and salespersons that deal and sell only variable annuities and other variable insurance products. Present chapter 485 provides such an exemption.²² Future chapter 485A does not. The securities commissioner reports that the exemption under present chapter 485 is not being used. Therefore, its repeal should have minimal, if any, impact on the industry. The commissioner's review of the commissioner's licensing records and those of the insurance commissioner indicates that over ninety-nine per cent of the salespersons, through their dealers, elected to be registered as securities salespersons.²³

¹⁴ Hawaii Revised Statutes section 485-1 (13).

¹⁵ Hawaii Revised Statutes section 485A-102.

¹⁶ Hawaii Revised Statutes section 485-15.

¹⁷ Hawaii Revised Statutes section 485-25.

¹⁸ Section 485-21, Hawaii Revised Statutes.

¹⁹ Comments on the preliminary draft of this report, from the Department of Commerce and Consumer Affairs, Business Registration Division, October 16, 2006.

²⁰ Hawaii Revised Statutes section 485A-412.

²¹ Hawaii Revised Statutes section 485A-501.

²² Hawaii Revised Statutes section 485-14.5.

²³ Correspondence from the Department of Commerce and Consumer Affairs, Business Registration Division, to the Legislative Reference Bureau, October 6, 2006, in response to questions submitted by the Bureau.

The Insurance Code

The insurance code contains a single, lengthy section governing variable contracts. It is found in the life insurance and annuities article, at Hawaii Revised Statutes section 431:10D-118. The section is the 1987 recodification of the precursor section 431-563,²⁴ and it is attributable to the model variable contract law, drafted by the National Association of Insurance Commissioners.²⁵ The purpose of section 431:10D-118 is to authorize domestic life insurance companies to establish one or more separate accounts and to allocate amounts to those accounts to provide for life insurance or annuities, payable in fixed or variable amounts or both.

Secondarily, the purpose of the section is to also prohibit insurance companies from issuing variable contracts in the State unless they are licensed life insurance companies or annuity businesses, and the insurance commissioner is satisfied that their operations in connection with the contracts are not hazardous to the public or policyholders in the State. A violation of the section is punishable as a misdemeanor.²⁶ Limited restitution in the form of contract replacement is available.²⁷

The term "variable contract" applies to two types of contracts. One is the variable annuity contract. The other is the variable life insurance policy. The statutory section was originally added to the insurance statutes in 1969 and was entitled "variable annuity contracts."²⁸ The section was originally needed to specifically authorize the maintenance of separate accounts for the premium payments on variable annuity contracts.²⁹ The section was subsequently amended in 1981 to also cover variable life insurance. Technically, the phrase "variable annuity contracts" was shortened to "variable contracts" and the phrase "annuities" was expanded to "life insurance or annuities."³⁰ The 1981 amendment was needed to extend the concept of separate accounts to include variable life insurance policies.³¹

Section 431:10D-118 also governs the particulars of establishing the separate accounts and issuing the variable contracts. With regard to the separate accounts, the section addresses income allocation, permissible investments, asset valuation, ownership of amounts, transfer of assets, and voting rights and special procedures.

With regard to the variable contracts, the section requires the inclusion of certain contract provisions. Specifically, it:

²⁴ Act 347, Session Laws of Hawaii 1987; Insurance Law Revision Corresponding Section Reference Table (1987), Hawaii Revised Statutes 2005 Replacement volume 9.

²⁵ Model Variable Contract Law, notes, page 260-5, Model Regulation Service--April 2005, National Association of Insurance Commissioners.

²⁶ Hawaii Revised Statutes section 431: 2-203 (b) (3).

²⁷ Comments on preliminary draft of this report, from the Department of Commerce and Consumer Affairs, Business Registration Division, October 16, 2006.

²⁸ Act 143, Session Laws of Hawaii 1969.

²⁹ Senate Standing Committee Report No. 974 on H.B. No. 765, Senate Journal 1969; House Standing Committee Report No. 526 on H.B. No. 765, House Journal 1969.

³⁰ Act 53, Session Laws of Hawaii 1981.

³¹ Senate Standing Committee Report No. 564 on S.B. No. 1359, Senate Journal 1981.

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- (1) Requires provisions that outline the procedures that will be used by the insurance company in determining the dollar amount of the variable benefits;
- (2) Requires provisions that state that the benefits are variable and that the dollar amount will vary to reflect investment experience;
- (3) Allows the inclusion of incidental death benefit provisions that are not subject to the provisions of the insurance code pertaining to life insurance carriers; and
- (4) Exempts variable contracts from specific provisions of the insurance code that would otherwise pertain to life insurance and annuities.

Finally, subsection (d) of this section grants the insurance commissioner the "sole and exclusive authority" to regulate the issuance and sale of variable contracts and to provide for the licensing of persons selling those contracts. This sole and exclusive authority is granted to the commissioner, "notwithstanding any other provision of law." The securities act is not referenced in particular. This subsection (d) first appeared as part of the original 1969 act that authorized variable contracts.³² The text of the subsection remains unchanged since 1969. Clarifying amendments have never been made to it. The provision reads as follows:

(d) Notwithstanding any other provision of law, the commissioner shall have sole and exclusive authority to regulate the issuance and sale of variable contracts and to provide for licensing of persons selling such contracts, and to issue such reasonable rules and regulations as may be appropriate to carry out the purposes and provisions of this section.

The securities commissioner points out that, despite the "sole and exclusive authority" language, a person selling a variable annuity is still subject to licensing by the National Association of Securities Dealers and any other state securities agency requiring securities registration.³³

The insurance commissioner points out that the "sole and exclusive" language must be interpreted in the context of the commissioner's authority under the insurance code. Variable annuities are "wrapped" in an insurance contract and are issued by life insurance companies. Accordingly, it is appropriate for the insurance commissioner to have sole and exclusive authority over the insurance aspect of variable annuities.

The insurance commissioner also concurs with the position of the securities commissioner that:

- (1) The securities commissioner has oversight over variable annuity contract sales practices and has the ability to respond to customer complaints and take appropriate enforcement actions;

³² Act 143, Session Laws of Hawaii 1969.

³³ Comments on the preliminary draft of this report, submitted by the Department of Commerce and Consumer Affairs, Business Registration Division, October 16, 2006.

- (2) As the protection of investors has never been the focus of Hawaii's insurance code, the code does not provide the insurance commissioner with the tools to adequately protect variable annuity customers; and
- (3) Under the securities act, an investor can choose to rescind purchases of variable annuity contracts and the securities commissioner has the authority to order the return of the full amount of the investor's investment, plus interest and costs. The insurance commissioner, in contrast, does not have similar authority to grant restitution to aggrieved customers.³⁴

Regulatory Framework and Enforcement Activities Under the Securities Act by the Securities Commissioner and Under the Variable Contract Law by the Insurance Commissioner

The securities commissioner points out that product regulation and sales practices regulation of variable annuities are two separate issues. Table 2 below, provided by the securities commissioner,³⁵ and presented earlier in chapter 2 of this report, sets out the regulatory framework over variable annuity contracts and the entities involved in their issuance and sale:

Table 2. State of Hawaii Variable Annuities Enforcement

Jurisdiction	State of Hawaii Insurance Commissioner	State of Hawaii Securities Commissioner
Insurance Company	X	
Variable Annuity Contract	X	
Broker-dealer		X
Salesperson	X	X
Sales Practice Abuses		X

The securities commissioner reports that the regulation of insurance companies rests exclusively with the insurance commissioner. Registration and regulation of variable products rests with the insurance commissioner. Under the Uniform Securities Act, the securities commissioner has regulatory oversight over only variable annuity sales practices. The securities commissioner responds to customer complaints and takes appropriate enforcement actions. The securities commissioner also has jurisdiction over fraudulent practices regarding the product. For example, if the prospectus contains material misrepresentations or omissions of material facts, the securities commissioner has the power to enjoin the sale of the product.³⁶

³⁴ Correspondence from the Department of Commerce and Consumer Affairs, Insurance Division, to the Legislative Reference Bureau, October 19, 2006, in response to questions submitted by the Bureau.

³⁵ Correspondence to the Legislative Reference Bureau, September 29, 2006, from the Department of Commerce and Consumer Affairs, Business Registration Division.

³⁶ Correspondence from the Department of Commerce and Consumer Affairs, Business Registration Division, to the Legislative Reference Bureau, October 6, 2006, in response to questions submitted by the Bureau.

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With regard to enforcement and compliance activities involving variable annuities, the securities commissioner reports that, as of October 6, 2006, it has thirteen current cases involving variable annuities. At least twenty-eight persons are alleged to be victims of switching, lack of supervision, the failure to disclose fees and other important characteristics, and unsuitable recommendations.³⁷

Two variable annuity cases recently concluded by the securities commissioner involved Waddell & Reed, Inc., as mentioned earlier, and the Centaurus Financial Services, Inc.

In 2005, Waddell & Reed, Inc, a financial services group who distributes products through a network of financial advisors, was fined \$7,000,000 by the National Association of Securities Dealers and state securities and insurance regulators, including the securities commissioner and the insurance commissioner of the State of Hawaii, and agreed to pay \$11,000,000 in restitution for recommending to over 5,000 customers that they exchange their variable annuities without determining the suitability of such exchanges. Waddell & Reed allegedly engaged in a deliberate campaign to switch customers from one variable annuity to another annuity product that provided greater compensation to its sales force. These exchanges generated \$37,000,000 in commissions and cost its customers nearly \$10,000,000 in surrender fees.³⁸

In January 2006, the securities commissioner settled with Centaurus Financial Services, Inc., for making unauthorized trades in a variable annuity subaccount and establishing discretionary authority over the client's accounts without prior written authorization from the client and causing the client to lose over \$4,400.³⁹

The insurance commissioner, likewise, reports that both the commissioner and the securities commissioner share an overlap in enforcement and compliance activity over variable annuity contracts. This is because the variable annuity contract is an insurance contract funded by equities. The insurance commissioner oversees the contract language and the licensing and sale of the insurance contract. The securities commissioner oversees the appropriateness of the investment advice, ascertaining whether the mix of equities that fund the annuity matches the risk profile of the customer.⁴⁰

With regard to enforcement and compliance activities, the insurance commissioner also reports that the commissioner has seen instances of misleading sales or the replacement of an existing contract with a contract that is similar and does not benefit the consumer. The purpose of the transaction is to generate a commissionable sale for the insurance producer. Here, the

³⁷ Correspondence from the Department of Commerce and Consumer Affairs, Business Registration Division, to the Legislative Reference Bureau, October 6, 2006, in response to questions submitted by the Bureau.

³⁸ Correspondence from the Department of Commerce and Consumer Affairs, Business Registration Division, to the Legislative Reference Bureau, October 6, 2006, in response to questions submitted by the Bureau.

³⁹ Correspondence from the Department of Commerce and Consumer Affairs, Business Registration Division, to the Legislative Reference Bureau, October 6, 2006, in response to questions submitted by the Bureau.

⁴⁰ Correspondence from the Department of Commerce and Consumer Affairs, Insurance Division, to the Legislative Reference Bureau, October 19, 2006, in response to questions submitted by the Bureau.

insurance commissioner relies on its working relationship with the securities commissioner when suitability issues arise, since the securities commissioner handles suitability issues.⁴¹

A Brief Legislative History of Variable Annuity Contracts Under the Uniform Securities Acts and the Insurance Code

Variable annuities have undergone changes in classification under both the securities act and the insurance code.

Under the securities acts, the classification of a variable annuity contract has changed at least twice, due to action by the legislature.

In 1957, the legislature replaced the uniform sale of securities act with the Uniform Securities Act (modified).⁴² The term "security" was defined to

[N]ot include any ... annuity contract under which an insurance company promises to pay a fixed number of dollars either in a lump sum or periodically for life or some other specified period.⁴³

The definition itself does not expressly include or exclude variable annuities. Furthermore, the recorded legislative history for the 1957 act sheds no light on whether this definition was intended to include or exclude variable annuities. The committee reports contain no reference to variable annuity contracts.⁴⁴

However, secondary resources shed some light on the intent of the language. According to the official code comments to the uniform act, which were adopted by the legislature, the term "security" is defined so as to not exclude a variable annuity.⁴⁵ Stated otherwise, the term is defined to include a variable annuity contract. Thus, the legislature can be said to have made a determination that, under the securities act, variable annuity contracts were securities.

In 1969, however, when it adopted the variable annuity contracts law through Act 143, discussed below, the legislature also used the same act to make some clarifying amendments to the Uniform Securities Act (modified). Amendments were described in text, rather than displayed as in the Ramseyer format (in which deleted language is bracketed and new language is underscored).

Section 2 of Act 143, Session Laws of 1969, reads as follows:

⁴¹ Correspondence from the Department of Commerce and Consumer Affairs, Insurance Division, to the Legislative Reference Bureau, October 19, 2006, in response to questions submitted by the Bureau.

⁴² House Standing Committee Report No. 931 on S.B. No. 419, House Journal 1957; Senate Standing Committee Report No. 231 on S.B. No. 419, Senate Journal 1957.

⁴³ Act 314, section 1, Session Laws of Hawaii 1957.

⁴⁴ House Standing Committee Report No. 931 on S.B. No. 419, House Journal 1957; Senate Standing Committee Report No. 231 on S.B. No. 419, Senate Journal 1957.

⁴⁵ Uniform Securities Act (1956), as Amended, page 37, official code comment on section 401(l). National Conference of Commissioners on Uniform State Laws, at <http://www.nasaa.org>.

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The last sentence of Subsection (l) of section 199-1, Revised Laws of Hawaii, 1955, as amended, is hereby amended by inserting a period after the words "annuity contract" and deleting the remainder of that sentence.

The text of section 199-1(l) is not set out in the act, so one needs to look for it in the Revised Laws of Hawaii, 1955, which is a precursor to the Hawaii Revised Statutes. It turns out that chapter 199 of the Revised Laws of Hawaii, 1955, relates to the uniform sales of securities act, itself a precursor to the present Uniform Securities Act set out in chapter 485 of the Hawaii Revised Statutes. It turns out too that section 199-1(l) is the definition of "security." The last sentence of it reads as follows:

"Security" does not include any ... annuity contract under which an insurance company promises to pay a fixed number of dollars either in a lump sum or periodically for life or some other specified period.

This definition of "security" excludes only a fixed annuity contract. The change that Act 143 works upon the last sentence of subsection (l) of section 199-1 is to render the text to read as follows:

"Security" does not include any ... annuity contract.

In effect, the legislature amended the definition of "security" so as to exclude not only a fixed annuity contract but also a variable annuity contract. The recorded legislative history for the 1969 model variable contracts law is silent on the amendments to the Uniform Securities Act (modified). The committee reports do not even mention that the amendments were made.⁴⁶ It can be inferred that the amendments were made to provide consistency with the language in the model variable contracts law that gives the insurance commissioner the sole and exclusive authority over the issuance and sale of variable annuity contracts.

In 1984, the legislature visited the definition of "security" once again. This time, the legislature amended the definition of "security" to expressly include a "variable annuity contract." The legislature also amended the exclusionary language in the definition to have the exclusion apply only to a fixed annuity contract, so that the language read as follows:

"Security" does not include any ... fixed annuity contract.

The amendment to the exclusionary language thus amounted to a repeal of the 1969 amendment, which had made the exclusionary language applicable to any annuity contract, fixed or variable. Accordingly, the legislature determined that variable annuity contracts were once again securities under the securities act. The recorded legislative history for the 1984 act indicates that the defining "security" to include a variable annuity contract would permit the securities commissioner to more effectively monitor the activities of securities broker/dealers and securities salespersons who offered variable annuity contracts.⁴⁷

⁴⁶ Senate Standing Committee Report No. 974 on H.B. No. 765, Senate Journal 1969; House Standing Committee Report No. 526 on H.B. No. 765, House Journal 1969.

⁴⁷ House Standing Committee Report No. 686-84 on S.B. No. 1694-84, House Journal 1984.

Thus, under the securities act, variable annuity contracts were deemed securities from 1957 to 1969. Then the first change occurred. From 1969 to 1984, they were not considered securities. The securities act did not apply to them; instead they were under the sole and exclusive authority of the insurance commissioner. Then the second change occurred. From 1984 to the present, they were again considered securities. They will continue to be considered securities when the new Uniform Securities Act (2002) takes effect in 2008.

Meanwhile, under the insurance code, the classification of a variable annuity contract has changed at least twice, due to action by both the legislature and the attorney general.

Prior to 1969, there was no variable contract law yet in the insurance code. Instead the code contained a definition of life insurance, which specified that the "transacting of life insurance includes the granting of annuities."⁴⁸

In 1958, the attorney general offered his first opinion on whether the definition covered variable annuity contracts. The attorney general had been asked by the treasurer of the territory whether the insurance commissioner could license under the existing Hawaii insurance laws a couple of out-of-state life insurance companies who had proposed to issue variable annuity contracts in the territory. The attorney general opined that the definition of life insurance covered variable annuity contracts. The reason was that there had been no clear legislative indication that "annuities" should not include "variable annuities." The insurance code was enacted with the legislative intent to "regulate the entire field and not leave interstices that would only be subject to federal regulation."⁴⁹ A restricted interpretation of the definition, in which "annuities" did not include variable annuities, would have left such an interstice.

In 1961, however, the attorney general reversed his position in a subsequent opinion. The attorney general had been asked by the insurance commissioner whether securities sought to be registered by a particular corporation under the state securities act were also subject to the insurance laws. The attorney general said they were not. He opined that the definition of life insurance did not cover variable annuity contracts; rather, variable annuity contracts were securities, not insurance. The reason was that, at the time that the definition of life insurance was adopted, variable annuity contracts were not yet in existence. They were not within the contemplation of that section. The attorney general also noted that a United States Supreme Court opinion had recently ruled that variable annuity contracts were securities under the federal Securities Act.⁵⁰

In 1969, the legislature took up the matter. The legislature amended the life insurance and annuities portion of the insurance code by adding the variable annuity contracts law.⁵¹ Basically, the new act authorized life insurers to establish separate accounts in order to finance variable annuity contracts, authorized only licensed life insurance companies to deliver those

⁴⁸ Section 181-7, Revised Laws of Hawaii 1955.

⁴⁹ A.G. Op. 58-135, July 28, 1958, Territory of Hawaii.

⁵⁰ A.G. Op. 61-89, September 12, 1961, State of Hawaii.

⁵¹ Model Variable Contract Law, notes, page 260-5, Model Regulation Service--April 2005, National Association of Insurance Commissioners.

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contracts, and gave the insurance commissioner the sole and exclusive authority to regulate the issuance and sale of those contracts. As stated earlier, clarifying amendments were made as well to the securities act to exclude variable annuity contracts from the definition of "security."⁵² Thus, variable annuity contracts were now deemed insurance, because they were incorporated into the insurance laws. The reason for the amendment, according to the recorded legislative history, was that the law at the time did not specifically authorize life insurance companies to establish separate accounts in order to finance variable annuity contracts.⁵³

Thus, under the insurance laws, variable annuity contracts were deemed insurance from 1958 to 1961. Then the first change occurred. From 1961 to 1969, they were deemed not to be insurance. Then the second change occurred. From 1969 to the present, they again have been deemed to be insurance.

Finally, viewed simultaneously under both the insurance laws and the securities act, variable annuity contracts have at times been deemed insurance, securities, or both insurance and securities. Between 1957 and 1958, they were deemed securities under the securities act. Their status under the insurance laws was unclear. Between 1958 and 1961, they were deemed to be insurance under the insurance laws, and they also continued to be deemed securities under the securities act. Between 1961 and 1969, they were deemed not to be insurance under the insurance laws, but they continued to be deemed securities under the securities act. Between 1969 and 1984, they were deemed insurance under the insurance laws; however, they were deemed not to be securities under the securities act. Since 1984, they have continued to be deemed insurance under the insurance laws, and they have continued to be deemed securities under the securities act.

In short, Table 3 below, prepared by the securities commissioner (and the bureau), summarizes the history of the classification of variable annuity contracts as securities or insurance, or as both under Hawaii law.

Table 3. Variable Contracts: Insurance or Security?

Year	Insurance?	Security?
1957		Yes: Legislature adopts the 1956 Uniform Securities Act. The definition of "security" covers a variable annuity contract. Act 314, SLH 1957
1958	Yes: Attorney General issues first opinion: the definition of "life insurance" covers variable annuities. AG Op 58-135	

⁵² Act 143, Session Laws of Hawaii 1969.

⁵³ Senate Standing Committee Report No. 974 on H.B. No. 765, Senate Journal 1969; House Standing Committee Report No. 526 on H.B. No. 765, House Journal 1969.

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Year	Insurance?	Security?
1961	No: Attorney General issues second opinion: the definition of "life insurance" does not cover variable annuities. AG Op 61-89	
1969	Yes: Legislature enacts the variable annuity contracts law. Act 143, SLH 1969	No: Legislature removes variable annuity contracts from the definition of "security". Act 143, SLH 1969
1984		Yes: Legislature expressly adds variable annuity contracts into the definition of "security". Act 281, SLH 1984
1987	Yes: Insurance Code is signed into law. Act 347	
1988	Yes: Insurance Code becomes effective.	
2006		Yes: Uniform Securities Act (2002) is signed into law. The definition of "security" expressly includes variable annuity contracts. Act 229, SLH 2006
2008		Yes: Uniform Securities Act (2002) becomes effective.

Chapter 5

STATE SECURITIES ACTS

Introduction

This is the main chapter of this report. This chapter presents findings on whether or not the securities acts in the fifty states define "security" to include a variable annuity contract. Where a security act defines "security" to include a variable annuity contract, sales practice abuses involving a variable annuity contract will fall under the scope of the act.

Findings

All fifty states have securities acts. The official designated to administer or oversee such acts differs from state to state. It can be the securities commissioner, the corporation commission, the banking commissioner, the attorney general, the secretary of state, the commissioner of financial institutions, the commissioner of commerce, the state auditor, the director of banking and finance, or the director of the department of business regulation. From here on we refer to them collectively as the "securities commissioner."

A variable annuity contract is one of two things under any security act. Either it is a security or it is not a security. If a variable annuity is a security, the securities act applies to it, and sales practice abuses relating to variable annuity contract will fall under the jurisdiction of the securities administrator. If a variable annuity contract is not a security, the securities act does not apply to it. Sales practice abuses relating to variable annuity contract will not fall under the jurisdiction of the securities administrator. For example, under the 2002 version of the Uniform Securities Act: "When variable products are included in the definition of security and exempted from registration[,] state securities administrators can bring enforcement actions concerning variable insurance sales practices."¹

Our research indicates that the securities acts in a majority of fifty states (seventy-two percent) do not apply to variable annuity contracts. The securities acts in the remaining states (twenty-eight percent) do apply to variable annuity contracts. Specifically, the securities acts in thirty-six states do not apply to a variable annuity contract. The securities acts in the remaining fourteen states, including Hawaii, apply to a variable annuity contract.

The securities acts of thirty-nine of the fifty states are based on one of three versions of the Uniform Securities Act. All three versions were drafted by the National Conference of Commissioners on Uniform State Laws. The 1956 version is in effect in twenty-five states.²

¹ Uniform Securities Act (Last Revised or Amended in 2005), pages 32-34, official code comment on section 102(28). National Conference of Commissioners on Uniform State Laws, at <http://www.uniformsecuritiesact.org>.

² Uniform Securities Act: 1956 Act, As Amended in 1958, Table of Jurisdictions Wherein 1956 Act Has Been Adopted, General Statutory Notes, Uniform Laws Annotated, Business and Financial Laws.

Table 4. Variable Annuities Under State Securities Acts

State	Uniform Securities Act Version	Regulator	"Security" Includes	"Security" Excludes	Status of a Variable Annuity
Alabama	1956	Alabama securities commission AC 8-6-50	Annuity contract AC 8-6-2 (10)	Annuity contract issued by an insurance company AC 8-6-2 (10)	Not a security
Alaska	1956	Commissioner of the department of commerce, community, and economic development AS 45.55.905 (a), 45.55.990	-- AS 45.55.990 (32)	Annuity contract under which an insurance company promises to pay a fixed or variable sum of money either in a lump sum or periodically for life or for some other specified period AS 45.55.990 (32)	Not a security Confirmed
Arizona	Non	Corporation commission ARS 44-1801, 44-1821	-- ARS 44-1801 (26)	-- ARS 44-1801 (26)	Security Confirmed
Arkansas	1956	Securities commissioner AC 23-42-201 (a)	Variable annuity contract AC 23-42-102 (15) (A) (xii)	Except as set forth in subdivision (15)(A)(xiii) of this section [viatical settlement contract], "security" does not include any insurance or endowment policy or annuity contract or variable annuity contract issued by any insurance company; AC 23-42-102 (15) (B)	Not a security Confirmed
California	Non	Commissioner of corporations of the department of corporations, in the business and transportation agency Ca Corp Code 25600	-- CCC 25019	Annuity contract under which an insurance company admitted in this state promises to pay a sum of money (whether or not based upon the investment performance of a segregated fund) either in a lump sum or periodically for life or some other specified period CCC 25019	Not a security

State	Uniform Securities Act Version	Regulator	"Security" Includes	"Security" Excludes	Status of a Variable Annuity
Colorado	1985	Securities commissioner CRS 11-51-703 (1)	-- CRS 11-51-201 (17)	Annuity contract under which an insurance company promises to pay a sum of money either in a lump sum or periodically for life or some other specified period CRS 11-51-201 (17)	Not a security Confirmed
Connecticut	1956	Banking commissioner CGS 36b-3 (6), 36b-25 (a)	-- CGS 36b-3 (17)	Annuity contract issued by an insurance company which is subject to regulation by the insurance commissioner CGS 36b-3 (17)	Not a security Confirmed
Delaware	1956	Attorney general DC title 6, 7325 (a)	-- DC, title 6, 7302 (a) (17)	Annuity contract under which an insurance company promises to pay money either in a lump sum or periodically for life or for some other specified period DC, title 6, 7302 (a) (17)	Not a security
Florida	Non	Office of financial regulation of the financial services commission FS 517.021 (7), (8), 517.03 (1)	-- FS 517.021 (21)	-- FS 517.021 (21)	Security Confirmed
Georgia	Non	Secretary of state GC 10-5-10 (a)	-- GC 10-5-2 (a) (26)	Annuity contract under which an insurance company promises to pay a fixed number of dollars either in a lump sum or periodically for life or some other specified period nor any variable annuity contract as provided for and regulated under title 33 and issued by a life insurance company licensed to do business in the State of Georgia GC 10-5-2 (a) (26)	Not a security

State	Uniform Securities Act Version	Regulator	"Security" Includes	"Security" Excludes	Status of a Variable Annuity
Hawaii (repeal on 7/1/08)	1956	Commissioner of securities HRS 485-2 (a)	Variable annuity contract HRS 485-1 (13)	Fixed annuity contract HRS 485-1 (13)	Security
Hawaii (eff 7/1/08)	2002	Commissioner of securities HRS 485A-102, 485A-601 (a)	Variable annuity contract HRS 485A-102	An insurance or endowment policy or annuity contract under which an insurance company promises to pay a fixed sum of money either in a lump sum or periodically for life or other specified period HRS 485A-102	Security
Idaho	2002	Director of the department of finance IS 30-14-102(1), 30-14-601(a)	-- IS 30-14-102 (28)	Annuity contract under which an insurance company promises to pay money either in a lump sum or periodically for life or other specified period IS 30-14-102 (28)	Not a security Confirmed
Illinois	Non	Secretary of state 815 ILCS 5/11 (A)(1)	-- 815 ILCS 5/2.1	-- 815 ILCS 5/2.1	Not a security Confirmed
Indiana	1956	Securities commissioner of the securities division in the office of the secretary of state IC 23-2-1-15 (a)	-- IC 23-2-1-1 (k)	Annuity contract under which an insurance company promises to pay money either in a lump sum or periodically for life or some other specified period IC 23-2-1-1 (k)	Not a security Confirmed
Iowa	2002	Commissioner of insurance IC 502.601 (1)	-- IC 502.102 (28)	It does not include an insurance or endowment policy or annuity contract under which an insurance company promises to pay a fixed or variable sum of money either in a lump sum or periodically for life or other specified period IC 502.102 (28) (b)	Not a security Confirmed

State	Uniform Securities Act Version	Regulator	"Security" Includes	"Security" Excludes	Status of a Variable Annuity
Kansas	2002	Securities commissioner KS 17-12a601 (a)	-- KS 17-12a102 (28)	Annuity contract under which an insurance company promises to pay a fixed or variable sum of money either in a lump sum or periodically for life or other specified period KS 17-12a102 (28)	Not a security
Kentucky	1956	Executive director of the office of financial institutions KRS 292.310 (4), 292.500	-- KRS 292.310 (18)	Annuity contract under which an insurance company promises to pay a fixed number of dollars either in a lump sum or periodically for life or some other specified period KRS 292.310 (18)	Security Confirmed
Louisiana	Non	Commissioner of financial institutions LRS 51:710 (A)	-- LRS 51:702 (15) (a)	Any variable annuity contract as provided for and regulated under Title 22 [Insurance] of the Louisiana Revised Statutes of 1950 and issued by a life insurance company licensed to do business in the state of Louisiana LRS 51:702 (15) (b)	Not a security
Maine	2002	Securities administrator of the office of securities in the department of professional and financial regulation MRS title 32, 16601 (1)	-- MRS title 32, 16102 (28)	Annuity contract under which an insurance company promises to pay a fixed or variable sum of money either in a lump sum or periodically for life or other specified period MRS title 32, 16102 (28)	Not a security Confirmed
Maryland	1956	Securities commissioner of the division of securities in the office of the attorney general MC, Corporations and Associations, 11-201 (a)	-- MC Corp. and Assoc. 11-101 (r) (1)	Annuity contract under which an insurance company promises to pay money either in a lump sum, periodically for life, or some other specified period MC Corp. and Assoc. 11-101 (r) (2)	Not a security Confirmed

State	Uniform Securities Act Version	Regulator	"Security" Includes	"Security" Excludes	Status of a Variable Annuity
Massachusetts	1956	Secretary of the commonwealth MGL 110A-401 (a), 110A-406 (a)	-- MGL 110A-401 (k)	Annuity contract under which an insurance company promises to pay money either in a lump sum or periodically for life or some other specified period MGL 110A-401 (k)	Security Enforcement actions
Michigan	1956	Office of financial and insurance services of the department of consumer and industry services MCL 451.801 (a), 451.806 (a)	-- MCL 451.801 (z)	Annuity contract under which an insurance company promises to pay money either in a lump sum or periodically for life or some other specified period or a commodity contract MCL 451.801 (z)	Not a security Confirmed
Minnesota (repeal on 8/1/07)	1956	Commissioner of commerce MS 80A.19 (1)	-- MS 80A.14 (18) (a)	Annuity contract under which an insurance company promises to pay money either in a lump sum or periodically for life or for some other specified period MS 80A.14 (18) (a)	Not a security
Minnesota (eff 8/1/07)	2002	Commissioner of commerce MS 80A.41 (1), 80A.78	-- MS 80A.41 (28)	Annuity contract under which an insurance company promises to pay a fixed or variable sum of money either in a lump sum or periodically for life or other specified period MS 80A.41 (28)	Not a security Confirmed
Mississippi	1956	Secretary of state MC 75-71-107 (a)	-- MC 75-71-105 (n)	Annuity contract under which an insurance company promises to pay a fixed or variable sum of money, or both, either in a lump sum or periodically for life or some other specified period MC 75-71-105 (n)	Not a security Confirmed

State	Uniform Securities Act Version	Regulator	"Security" Includes	"Security" Excludes	Status of a Variable Annuity
Missouri	2002	Commissioner of securities MRS 409.6-601 (a)	-- MRS 409.1-102 (28)	Annuity contract under which an insurance company promises to pay money either in a lump sum or periodically for life or other specified period MRS 409.1-102 (28)	Security Enforcement actions
Montana	1956, 1985	State auditor MC 30-10-107 (1)	-- MC 30-10-103 (22) (a)	Annuity contract under which an insurance company promises to pay a fixed sum of money either in a lump sum or periodically for life or some other specified period MC 30-10-103 (22) (b)	Security Confirmed
Nebraska	1956	Director of banking and finance NRS 8-1120 (1)	-- NRS 8-1101 (15)	Annuity contract issued by an insurance company NRS 8-1101 (15)	Not a security
Nevada	1985	Secretary of state, and the administrator of the securities division of the office of the secretary of state NRS 90.215, 90.230, 90.710	-- NRS 90.295	Annuity contract under which an insurance company promises to pay a fixed sum of money either in a lump sum or periodically for life or some other specified period NRS 90.295	Security Confirmed
New Hampshire	1956	Secretary of state NHRS 421-B:21 (I)	-- NHRS 421-B:2 (XX) (a)	Annuity contract under which an insurance company promises to pay money either in a lump sum or periodically for life or for some other specified period NHRS 421-B:2 (XX) (a)	Not a security Confirmed
New Jersey	1956	Bureau of securities in the division of consumer affairs of the department of law and public safety NJPS 49:3-66 (a)	-- NJPS 49:3-49 (m)	Annuity contract under which an insurance company promises to pay a fixed or variable number of dollars either in a lump sum or periodically for life or some other specified period NJPS 49:3-49 (m)	Not a security Confirmed

State	Uniform Securities Act Version	Regulator	"Security" Includes	"Security" Excludes	Status of a Variable Annuity
New Mexico	1985	Director of the securities division of the regulation and licensing department NMS 58-13B-2 (E), 58-13B-44 (A)	-- NMS 58-13B-2 (X)	-- NMS 58-13B-2 (X)	Not a security Due to the exclusionary language in the variable contracts law. Confirmed
New York	Non	Attorney general NYCL, Gen Bus, article 23-A	-- NYGL, Gen Bus, article 23-A, 352 (1)	-- NYGL, Gen Bus, article 23-A, 352 (1)	Security Because variable annuity contracts are exempt from registration. NYCL, Gen Bus, article 23-A, 359-ff (5) (f)
North Carolina	1956	Secretary of state NCGS 78A-45 (a)	-- NCGS 78A-2 (11)	Annuity contract under which an insurance company promises to pay: A fixed sum of money either in a lump sum or periodically for life or for some other specified period, or Benefits or payments or value that vary so as to reflect investment results of any segregated portfolio of investments or of a designated separate account or accounts in which amounts received or retained in connection with a contract have been placed if the delivering or issuing insurance company has currently satisfied the Commissioner of Insurance that it is in compliance with G.S. 58-7-95 [separate accounts] NCGS 78A-2 (11)	Not a security

State	Uniform Securities Act Version	Regulator	"Security" Includes	"Security" Excludes	Status of a Variable Annuity
North Dakota	Non	Securities commissioner NDCC 10-04-03 (1)	Investment contract NDCC 10-04-02 (19)	-- NDCC 10-04-02 (19)	Security As an investment contract Confirmed
Ohio	Non	Commissioner of securities ORC 1707.32, 1707.46	-- ORC 1707.01	-- ORC 1707.01	Not a security Confirmed
Oklahoma	2002	Securities administrator OS 71-1-102 (1); 71-1-601	Investment contract OS 71-1-102 (32)	The term:...does not include an insurance or endowment policy or annuity contract under which an insurance company promises to pay a sum of money either in a lump sum or periodically for life or other specified period OS 71-1-102 (32)	Not a security If exclusion applies; otherwise, it is likely an investment contract, and thus a security. Confirmed
Oregon	1956	Director of the department of consumer and business services ORS 59.235	-- ORS 59.015 (19) (a)	Annuity contract under which an insurance company promises to pay a fixed or variable sum of money either in a lump sum or periodically for life or some other specified period ORS 59.015 (19) (b)	Not a security Confirmed
Pennsylvania	1956	Securities commission PS, title 70, 1-102 (f), 1-601 (a)	-- PS, title 70, 1-102 (t)	Annuity contract under which an insurance company admitted in this State promises to pay a sum of money (whether or not based upon the investment performance of a segregated fund) either in a lump sum or periodically for life or some other specified period PS, title 70, 1-102 (t)	Not a security Confirmed

State	Uniform Securities Act Version	Regulator	"Security" Includes	"Security" Excludes	Status of a Variable Annuity
Rhode Island	1985	Director of the department of business regulation RIGL 7-11-101(3), 7-11-701	variable annuity RIGL 7-11-101 (22)	Annuity contract under which an insurance company promises to pay a fixed sum of money either in a lump sum or periodically for life or some other specified period RIGL 7-11-101 (22)	Security
South Carolina	2002	Attorney general SCCL 35-1-601 (a)	-- SCCL 35-1-102 (29)	Annuity contract under which an insurance company promises to pay a sum of money either in a lump sum or periodically for life or other specified period SCCL 35-1-102 (29)	Not a security Confirmed
South Dakota	2002	Director of securities SDCL 47-31B-102 (1), 47-31B-601(a)	-- SDCL 47-31B-102 (28)	Annuity contract under which an insurance company promises to pay a fixed sum of money either in a lump sum or periodically for life or other specified period SDCL 47-31B-102 (28)	Security
Tennessee	Non	Commissioner of commerce and insurance TC 48-2-102 (6), 48-2-115 (a)	-- TC 48-2-102 (16)	Annuity contract under which an insurance company promises to pay money either in a lump sum or periodically for life or for some other specified period TC 48-2-102 (16)	Not a security Confirmed
Texas	Non	Securities commissioner VTCS 581-3	-- VTCS 581-4 (A)	Annuity contract, optional annuity contract, issued by an insurance company subject to the supervision or control of the Texas Department of Insurance when the form of such policy or contract has been duly filed with the Department as now or hereafter required by law VTCS 581-4 (A)	Not a security Confirmed

State	Uniform Securities Act Version	Regulator	"Security" Includes	"Security" Excludes	Status of a Variable Annuity
Utah	1956	Director of the division of securities of the department of commerce UC 61-1-18 (1)	-- UC 61-1-13 (1) (x) (i)	Annuity contract under which an insurance company promises to pay money in a lump sum or periodically for life or some other specified period UC 61-1-13 (1) (x) (ii)	Not a security
Vermont	2002	Commissioner of banking, insurance, securities, and health care administration VS, title 9, 5102 (4), 5601	-- VS, title 9, 5102 (28)	Annuity contract under which an insurance company promises to pay a fixed sum of money either in a lump sum or periodically for life or other specified period VS, title 9, 5102 (28)	Security Confirmed
Virginia	1956	State corporation commission VC 13.1-501 (A), 13.1-523.1	-- VC 13.1-501	Annuity contract or variable annuity contract issued by an insurance company subject to the supervision or control of the Commission's Bureau of Insurance when the form of such policy or contract has been duly filed with the Bureau as now or hereafter required by law VC 13.1-501	Not a security Confirmed
Washington	1956	Department of financial institutions WRC 21.20.450	-- WRC 21.20.005 (12) (a)	Annuity contract under which an insurance company promises to pay a fixed sum of money either in a lump sum or periodically for life or some other specified period WRC 21.20.005 (12) (b)	Security Confirmed
West Virginia	1956	Auditor WVC 32-4-401 (a), 32-4-406 (a)	-- WVC 32-4-401 (n)	Annuity contract under which an insurance company promises to pay money either in a lump sum or periodically for life or some other specified period WVC 32-4-401 (n)	Not a security Partly due to the exclusionary language in the variable contracts law. Confirmed

State	Uniform Securities Act Version	Regulator	"Security" Includes	"Security" Excludes	Status of a Variable Annuity
Wisconsin	1956	Division of securities WS 551.02 (4), 551.51 (1)	-- WS 551.02 (13) (a)	Any fixed or variable insurance or endowment policy or annuity contract under which an insurer promises to pay money either in a lump sum or periodically for life or some other specified period WS 551.02 (13) (b)	Not a security Confirmed
Wyoming	1956	Secretary of state WS 17-4-118 (a)	-- WS 17-4-113 (a) (xi)	Annuity contract under which an insurance company promises to pay money either in a lump sum or periodically for life or for some other specified period WS 17-4-113 (a) (xi)	Not a security Due to the exclusionary language in the variable contracts law. Confirmed

References

State Securities Acts

Alabama	Code of Alabama, sections 8-6-1 to 8-6-33
Alaska	Alaska Statutes, sections 45.55.010 to 45.55.995
Arizona	Arizona Revised Statutes, sections 44-1801 to 44-2126
Arkansas	Arkansas Code, sections 23-42-101 to 23-42-509
California	California Corporations Code, sections 25000 to 25707
Colorado	Colorado Revised Statutes, sections 11-51-101 to 11-51-908
Connecticut	General Statutes of Connecticut, sections 36b-2 to 36b-39
Delaware	Delaware Code, title 6, sections 7301 to 7330
Florida	Florida Statutes, sections 517.011 to 517.32
Georgia	Unannotated Georgia Code, sections 10-5-1 to 10-5-24
Hawaii	Hawaii Revised Statutes, sections 485-1 to 485-25 (repeal on 7/1/08) Hawaii Revised Statutes, sections 485A-101 to 485A-701 (effective 7/1/08)
Idaho	Idaho Statutes, sections 30-14-101 to 30-14-703
Illinois	Illinois Compiled Statutes, 815 ILCS 5/1 to 815 ILCS 5/19
Indiana	Indiana Code, sections 23-2-1-1 to 23-2-1-27
Iowa	Iowa Code, sections 502.101 to 502.701
Kansas	Kansas Statutes, sections 17-12a101 to 17-12a703
Kentucky	Kentucky Revised Statutes, sections 292.310 to 292.550, 292.991
Louisiana	Louisiana Revised Statutes, sections 51:701 to 51:724
Maine	Maine Revised Statutes, title 32, sections 16101 to 16702
Maryland	Maryland Code, Corporations and Associations article, sections 11-101 to 11-805
Massachusetts	Massachusetts General Laws, sections 110A-101 to 110A-417
Michigan	Michigan Compiled Laws, sections 451.501 - 451.818
Minnesota	Minnesota Statutes, sections 80A.01 to 80A.31 (repeal on 8/1/07) Minnesota Statutes, sections 80A.40 to 80A.90 (effective 8/1/07)
Mississippi	Mississippi Code, sections 75-71-101 to 75-71-735
Missouri	Missouri Revised Statutes, sections 409.1-101 to 409.7-703
Montana	Montana Code Annotated, sections 30-10-101 to 30-10-326
Nebraska	Nebraska Statutes, sections 8-1101 to 8-1123
Nevada	Nevada Revised Statutes, sections 90.211 to 90.860
New Hampshire	New Hampshire Revised Statutes Annotated, sections 421-B:1 to 421-B:34
New Jersey	New Jersey Permanent Statutes, sections 49:3-47 to 49:3-76
New Mexico	New Mexico Statutes Annotated, sections 58-13B-1 to 58-13B-57
New York	New York Consolidated Laws, General Business, article 23-A, sections 352 to 359-H
North Carolina	North Carolina General Statutes, sections 78A-1 to 78A-66
North Dakota	North Dakota Century Code, sections 10-04-01 to 10-04-20
Ohio	Ohio Revised Code, sections 1707.01 to 1707.99
Oklahoma	Oklahoma Statutes, sections 71-1-101 to 71-1-701
Oregon	Oregon Revised Statutes, sections 59.005 to 59.451, 59.991, and 59.995
Pennsylvania	Unconsolidated Pennsylvania Statutes, title 70, sections 1-101 to 1-704
Rhode Island	Rhode Island General Laws, sections 7-11-101 to 7-11-806
South Carolina	South Carolina Code of Laws, sections 35-1-101 to 35-1-703
South Dakota	South Dakota Codified Laws, sections 47-31B-101 to 47-31B-703
Tennessee	Tennessee Code, sections 48-2-101 to 48-2-201
Texas	Vernon's Texas Civil Statutes, articles 581-1 to 581-43

Title of report or chapter

Utah	Utah Code, sections 61-1-1 to 61-1-30
Vermont	Vermont Statutes, title 9, sections 5101 to 5612
Virginia	Code of Virginia, sections 13.1-501 to 13.1-527.3
Washington	Revised Code of Washington, sections 21.20.005 to 21.20.940
West Virginia	West Virginia Code, sections 32-1-101 to 32-4-418
Wisconsin	Wisconsin Statutes, sections 551.01 to 551.69
Wyoming	Wyoming Statutes, sections 17-4-101 to 17-4-129

Other

Uniform Securities Act (1956), as amended in 1958. Uniform Laws Annotated, Business and Financial Laws. Also, National Conference of Commissioners on Uniform State Laws, at www.nasaa.org.

Uniform Securities Act (1985) with 1988 amendments. Uniform Laws Annotated, Business and Financial Laws. Also, National Conference of Commissioners on Uniform State Laws, at www.uniformsecuritiesact.org.

Uniform Securities Act (last revised or amended in 2005). Uniform Laws Annotated, Business and Financial Laws. Also, National Conference of Commissioners on Uniform State Laws, at www.uniformsecuritiesact.org.

North American Securities Administrators Association, website at <http://www.nasaa.org>, which provides links to the websites of the securities administrators of the fifty states.

Blue Sky Regulation Second Edition, §7.05 Insurance Company Securities, Robert N. Rapp, Lexis Nexis.

The 1985 version is in effect in four states.³ The 2002 version is in effect in nine states.⁴ A combination of the 1956 and 1985 acts is reportedly in effect in one state (Montana). The remaining eleven states have securities acts that are not immediately attributable to any version of the Uniform Securities Act. (In the near future, the 2002 version of the Uniform Securities Act is scheduled to replace the 1956 act in both Hawaii and Minnesota. The effective dates for the repeal and replacement are July 1, 2008 for Hawaii,⁵ and August 1, 2007, for Minnesota.⁶)

With regard to states that have adopted or enacted the 2002 version of the Uniform Securities Act, these fairly recent enactments or adoptions provide an unscientific gauge of recent trends in the classification of variable annuity contracts under state securities acts. Eleven states have adopted or enacted the 2002 version (including Hawaii and Minnesota). Most of them have classified variable annuity contracts as not being securities under their securities act. Specifically, variable annuity contracts are not securities under the securities act in seven of the states, and they are securities under the securities acts in four of the states. Stated otherwise, thirty-six percent of the states enacting the 2002 version of the uniform securities act have enacted the version so as to include variable annuities in the definition of "security." This percentage is higher than the overall twenty-eight percent of all fifty states whose securities acts apply to variable annuities.

Approaches to Determining the Status of Variable Annuity Contracts Under State Securities Acts

Our findings above are based primarily upon four approaches used in this report to determine whether variable annuity contracts are securities under other states' securities acts.

One approach was the direct approach. Where e-mail addresses were readily available on the websites of other states' securities administrators, we e-mailed the securities administrators of the other states for their own interpretation of their securities acts. We asked them whether a variable annuity contract was a security or was not a security under the securities act of their states.

Were it not for this direct approach, we would not have known that in North Dakota, the securities commissioner deems variable annuity contracts to be securities because they are investment contracts, and investment contracts are included in the definition of "security." Nor would we have known that in New Mexico, West Virginia, and Wyoming, the officials in charge of securities regulation give weight to the exclusionary language in the variable contracts law in deeming variable annuities not to be securities under the securities act.

³ Uniform Securities Act (1985) with 1988 Amendments, Table of Jurisdictions Wherein 1985 Act Has Been Adopted, General Statutory Notes, Uniform Laws Annotated, Business and Financial Laws.

⁴ Uniform Securities Act (Last Revised or Amended in 2002), Table of Jurisdictions Wherein 2002 Act Has Been Adopted, General Statutory Notes, Uniform Laws Annotated, Business and Financial Laws. Also, on the Internet at <http://www.uniformsecuritiesact.org>.

⁵ Act 229, section 20, Session Laws of Hawaii 2006.

⁶ 2006 Minnesota Laws page 5518. Session law chapter 196, article 1, section 52.

*VARIABLE ANNUITY CONTRACTS UNDER STATE STATUTES
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A second approach was an indirect approach. Evidence of enforcement actions relating to variable annuity contracts, brought under the securities acts in other states, allowed us to infer that those securities commissioners interpret their securities acts to cover variable annuity contracts. Evidence of enforcement activities included consent orders and agreements. This was the approach taken for Massachusetts⁷ and Missouri.⁸

A third approach was to interpret the definition of "security" in context with the provision on "exempt securities." It was a continuation of our fourth approach. Where the definition of a "security" in a state's security act did not expressly include or exclude a variable annuity contract, we were able to make a determination based on the sections of the act relating to "exempt securities," i.e., those securities that were exempt from registration but are nonetheless securities. If the section on exempt securities appeared to apply to a variable annuity contract, we inferred that a variable annuity contract must therefore be a security under that state's securities act.

We used this approach with the New York securities act, where the definition of "security" is silent on annuities. However, the section on exempt securities contains language which appears to refer to variable annuity contracts.⁹

The fourth approach was to interpret statutory text, specifically, the definition of "security." This was actually our primary approach, and it was the most time-consuming. We looked for and interpreted the text of other states' securities acts as best as we could. For a state's securities act, we reviewed the definition of a "security" to determine whether variable annuity contracts were being included as a security or excluded as a security.

⁷ In the Matter of: Citizens Investment Services Corp., Consent Order, July 22, 2005, Commonwealth of Massachusetts, Secretary of the Commonwealth. The consent order relates to unsuitable sales of variable annuities to seniors and the failure to retain e-mails.

Memorandum of Understanding between the Massachusetts Securities Division and Banc of America Investment Services, Inc., July 12, 2005, Commonwealth of Massachusetts, Secretary of the Commonwealth. The Massachusetts Securities Division entered into a memorandum of understanding with Banc of America Investment Services, Inc. relating to the sales of variable annuity products to Massachusetts customers. The agreement was reached after the division commenced an inquiry into the sales practices of the bank in connection with the sales of variable annuity products to Massachusetts customers seventy-five years of age and older at the time of purchase.

⁸ Case No. AP-06-17, ... Consent Order, June 6, 2006, State of Missouri, Office of the Secretary of State. The commissioner of securities entered into a consent order on June 6, 2006 with a registered agent who, as the commissioner alleges, engaged in dishonest or unethical practices involving variable annuities. The consent order placed the agent under heightened supervision for twelve months for any sales of variable annuities.

Case No. AP-06-17, ... Consent Order, June 1, 2006, State of Missouri, Office of the Secretary of State. The commissioner of securities entered into a consent order on June 1, 2006 with a registered agent who, as the commissioner alleges, recommended that a fifty-three year old woman put 85-90% of her liquid net assets in a variable annuity. The consent order prohibited the agent from selling variable annuities in Missouri for a sixty day period.

Case No. AP-05-13, In the Matter of: Wadell & Reed, Inc. CRD #866, et al, March 25, 2005, Summary Order of Suspension, State of Missouri, Commissioner of Securities. The commissioner of securities issued a summary order of suspension on March 25, 2005 of Waddell & Reed's broker-dealer registration. The suspension relates to variable annuity switching.

⁹ NYCL, General Business, article 23-A, 359-ff (5) (f) exempts from registration a security "which constitutes an insurance or endowment policy or annuity contract or interest or participation therein, whether payable in fixed or variable dollar amounts or both, issued by an institution subject to the supervision of the superintendent of insurance of this state."

In reading the statutes, we applied as rules of interpretation the rules of drafting found in the official code comments to the three versions of the Uniform Securities Act. We applied these rules of interpretation to the statutory text of states that adopted the Uniform Securities Act, in one of its three versions. We also applied these same rules to the statutory text of states that did not adopt any version of the Uniform Securities Act, to the extent possible.

As a technical matter, a proposed draft of Uniform Securities Act may set out a statutory provision that contains a phrase that is surrounded by brackets. The inclusion or deletion of that bracketed phrase, in the final draft passed by a legislature, will have significance. According to the official code comments, if the bracketed phrase is left in the provision, the provision will be interpreted in a particular way. If the bracketed phrase is removed, the provision will be interpreted in a different way.

Also, in determining which version of the Uniform Securities Act a particular state adopted, we referred to the tables and notes of helpful secondary sources, specifically, the publication *Uniform Laws Annotated* and the websites www.uniformsecuritiesact.org, and www.law.cornell.edu.

We explain specifically how the drafting rules work with the three versions of the Uniform Securities Act.

In all three versions of the Uniform Securities Act, the term "security" is defined mainly by examples. The definition lays out examples of what is a security. It also lays out examples of what is not a security. Variable annuity contracts are not expressly listed among the examples given as a security. Whether they are or are not securities seems to depend on whether they have been listed among the examples of what are not securities. In other words, they are or are not securities depending on how they are treated in the exclusionary last sentence in the definition.

The 1956 Version of the Uniform Securities Act

In the 1956 version, the last sentence in the definition of "security" under section 401(l) of the act reads in whole as follows:

"Security" does not include any insurance or endowment policy or annuity contract under which an insurance company promises to pay [a fixed sum of] money either in a lump sum or periodically for life or for some other specified period.

According to the official code comment on the last sentence of section 401(l):

The last sentence has been explicitly phrased so as not to exclude from the definition the so-called "variable annuities" which have recently been developed...If it is desired to exclude variable annuities along with orthodox annuities on the ground that the former are sufficiently regulated by the insurance authorities in the particular state, the bracketed language should be deleted.¹⁰

¹⁰ Uniform Securities Act (1956), as Amended, page 37, official code comment on section 401(l). National Conference of Commissioners on Uniform State Laws, at <http://www.nasaa.org>.

In other words, retaining the bracketed phrase "a fixed sum of" in the definition means that "security" includes a variable annuity contract. In contrast, deleting the phrase means that "security" does not include a variable annuity contract. Accordingly, the term "annuity contract" is understood to include a variable annuity contract. This is a useful pointer for statutory interpretation, since the 1956 version has been adopted and is still in effect in about half of the states.

The 1985 Version of the Uniform Securities Act

The 1985 version is the only one of the three versions that is drafted on the premise that variable annuity contracts are securities. The exclusionary last sentence in the definition of "security" under section 101(16) of the act reads in part as follows:

The term does not include ... an insurance or endowment policy or annuity contract under which an insurance company promises to pay a fixed sum of money either in a lump sum or periodically for life or some other specified period;

According to the official code comment to section 101(16):

Similarly, insurance products providing for the payment of a fixed sum of money are excluded from the definition. Variable annuities and similar products are treated as securities under this definition, but are exempted from registration under Section 401(4).¹¹

In other words, the definition of "security" under the 1985 version includes variable annuity contracts. It appears that they are included as securities by default. The exclusionary last sentence covers only fixed annuities.

The 2002 Version of the Uniform Securities Act

In the 2002 version, the exclusionary last sentence of the definition of "security" in section 102(28) reads in part as follows:

The term ... does not include an insurance or endowment policy or annuity contract under which an insurance company promises to pay a fixed [or variable] sum of money either in a lump sum or periodically for life or other specified period;

According to the official code comment to section 102(28):

The Drafting Committee recognized that the decision whether to exclude variable annuities from the definition of security will be made on a state-by-state basis. Those

¹¹ Uniform Securities Act (1985), with 1988 Amendments, page 15, official code comment on section 101(16). National Conference of Commissioners on Uniform State Laws, at <http://www.uniformsecuritiesact.org>.

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states which intend to exclude variable products from the definition of security should add the words "or variable"..."¹²

Thus, retaining the phrase "or variable" in the exclusionary sentence of the definition means that "security" does not include a variable annuity contract. Deleting the bracketed phrase "or variable" means that "security" includes a variable annuity contract.

Table 4 beginning on the next page quotes verbatim the relevant statutory text of the several states. It also lists the version of the Uniform Securities Act adopted in the state, if any.

More importantly, it notes whether variable annuity contracts are deemed securities under that state's securities act. The accompanying notation "Confirmed" means that it was the securities commissioner of that state that so indicated whether a variable annuity is a security or is not a security under that state's securities act. The accompanying notation "Enforcement actions" means that we inferred that that particular state's securities commissioner deems variable annuities to be securities, based upon the existence of press releases or court documents that show enforcement actions relating to variable annuity contracts being brought under state securities acts. The presence of such activity constitutes a kind of indirect confirmation. Where there is no accompanying notation, it means that it is our office that is interpreting the definition of "security" in that state's securities act to include or not include a variable annuity contract, based upon the rules of interpretation found in the official code comments to the three versions of the Uniform Securities Act. In other words, the conclusion has not been confirmed.

¹² Uniform Securities Act (Last Revised or Amended in 2005), pages 32-34, official code comment on section 102(28). National Conference of Commissioners on Uniform State Laws, at <http://www.uniformsecuritiesact.org>.

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State Securities Acts

Alabama	Code of Alabama, sections 8-6-1 to 8-6-33
Alaska	Alaska Statutes, sections 45.55.010 to 45.55.995
Arizona	Arizona Revised Statutes, sections 44-1801 to 44-2126
Arkansas	Arkansas Code, sections 23-42-101 to 23-42-509
California	California Corporations Code, sections 25000 to 25707
Colorado	Colorado Revised Statutes, sections 11-51-101 to 11-51-908
Connecticut	General Statutes of Connecticut, sections 36b-2 to 36b-39
Delaware	Delaware Code, title 6, sections 7301 to 7330
Florida	Florida Statutes, sections 517.011 to 517.32
Georgia	Unannotated Georgia Code, sections 10-5-1 to 10-5-24
Hawaii	Hawaii Revised Statutes, sections 485-1 to 485-25 (repeal on 7/1/08) Hawaii Revised Statutes, sections 485A-101 to 485A-701 (effective 7/1/08)
Idaho	Idaho Statutes, sections 30-14-101 to 30-14-703
Illinois	Illinois Compiled Statutes, 815 ILCS 5/1 to 815 ILCS 5/19
Indiana	Indiana Code, sections 23-2-1-1 to 23-2-1-27
Iowa	Iowa Code, sections 502.101 to 502.701
Kansas	Kansas Statutes, sections 17-12a101 to 17-12a703
Kentucky	Kentucky Revised Statutes, sections 292.310 to 292.550, 292.991
Louisiana	Louisiana Revised Statutes, sections 51:701 to 51:724
Maine	Maine Revised Statutes, title 32, sections 16101 to 16702
Maryland	Maryland Code, Corporations and Associations article, sections 11-101 to 11-805
Massachusetts	Massachusetts General Laws, sections 110A-101 to 110A-417
Michigan	Michigan Compiled Laws, sections 451.501 - 451.818
Minnesota	Minnesota Statutes, sections 80A.01 to 80A.31 (repeal on 8/1/07) Minnesota Statutes, sections 80A.40 to 80A.90 (effective 8/1/07)
Mississippi	Mississippi Code, sections 75-71-101 to 75-71-735
Missouri	Missouri Revised Statutes, sections 409.1-101 to 409.7-703
Montana	Montana Code Annotated, sections 30-10-101 to 30-10-326
Nebraska	Nebraska Statutes, sections 8-1101 to 8-1123
Nevada	Nevada Revised Statutes, sections 90.211 to 90.860
New Hampshire	New Hampshire Revised Statutes Annotated, sections 421-B:1 to 421-B:34
New Jersey	New Jersey Permanent Statutes, sections 49:3-47 to 49:3-76
New Mexico	New Mexico Statutes Annotated, sections 58-13B-1 to 58-13B-57
New York	New York Consolidated Laws, General Business, article 23-A, sections 352 to 359-H
North Carolina	North Carolina General Statutes, sections 78A-1 to 78A-66
North Dakota	North Dakota Century Code, sections 10-04-01 to 10-04-20
Ohio	Ohio Revised Code, sections 1707.01 to 1707.99
Oklahoma	Oklahoma Statutes, sections 71-1-101 to 71-1-701
Oregon	Oregon Revised Statutes, sections 59.005 to 59.451, 59.991, and 59.995
Pennsylvania	Unconsolidated Pennsylvania Statutes, title 70, sections 1-101 to 1-704
Rhode Island	Rhode Island General Laws, sections 7-11-101 to 7-11-806
South Carolina	South Carolina Code of Laws, sections 35-1-101 to 35-1-703
South Dakota	South Dakota Codified Laws, sections 47-31B-101 to 47-31B-703
Tennessee	Tennessee Code, sections 48-2-101 to 48-2-201

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Texas	Vernon's Texas Civil Statutes, articles 581-1 to 581-43
Utah	Utah Code, sections 61-1-1 to 61-1-30
Vermont	Vermont Statutes, title 9, sections 5101 to 5612
Virginia	Code of Virginia, sections 13.1-501 to 13.1-527.3
Washington	Revised Code of Washington, sections 21.20.005 to 21.20.940
West Virginia	West Virginia Code, sections 32-1-101 to 32-4-418
Wisconsin	Wisconsin Statutes, sections 551.01 to 551.69
Wyoming	Wyoming Statutes, sections 17-4-101 to 17-4-129

Other

Uniform Securities Act (1956), as amended in 1958. Uniform Laws Annotated, Business and Financial Laws. Also, National Conference of Commissioners on Uniform State Laws, at www.nasaa.org.

Uniform Securities Act (1985) with 1988 amendments. Uniform Laws Annotated, Business and Financial Laws. Also, National Conference of Commissioners on Uniform State Laws, at www.uniformsecuritiesact.org.

Uniform Securities Act (last revised or amended in 2005). Uniform Laws Annotated, Business and Financial Laws. Also, National Conference of Commissioners on Uniform State Laws, at www.uniformsecuritiesact.org.

North American Securities Administrators Association, website at <http://www.nasaa.org>, which provides links to the websites of the securities administrators of the fifty states.

Blue Sky Regulation Second Edition, §7.05 Insurance Company Securities, Robert N. Rapp, Lexis Nexis.

Chapter 6

STATE INSURANCE STATUTES

Introduction

This chapter confirms that all fifty states have insurance statutes that regulate variable annuity contracts. Stated otherwise, the insurance statutes of all fifty states deem variable annuity contracts to be "insurance."

Findings

All fifty states have insurance statutes that specifically pertain to variable annuity contracts, or more broadly, to variable contracts, which include variable annuity contracts. Depending on the state, the type of contract covered by the law is referred to variously as, including but not limited to, "variable contracts," "contract providing for variable benefits," "contracts providing benefits payable in variable amounts," "contract on a variable or indeterminate value basis," "variable annuity contracts," "contracts providing for ... annuity benefits fundable and/or computable as to cost or payment or both ... out of or on the basis of assets in a segregated investment account," "contracts ... providing for payments which vary directly according to investment experience," "variable annuity contracts that provide for payment varying directly with the investment experience of a segregated asset account," "contract under which amounts are to be allocated to one or more separate accounts," "agreement ... providing for the allocation of amounts to a separate account," "contract providing variable or fixed and variable benefits or contractual payments," "variable contract providing benefits in variable amounts," or "agreement providing benefits in variable amounts."

We refer to these laws collectively from here on simply as variable contract laws. These variable contract laws are generally found in the insurance code among provisions relating to life insurance and annuities. The official designated to administer or oversee the variable contract laws is usually denoted as the insurance commissioner, the superintendent of insurance, or the director of insurance, or like term. Some states designate other officials. From here on we refer to them collectively as the "insurance commissioner."

A key feature of the variable contract laws, for the purposes of this study, is the exclusive jurisdiction provision. Under this provision, the insurance commissioner has the sole authority, the exclusive authority, or the sole and exclusive authority, over the issuance and sale of the variable contracts, including, sometimes, the licensing of persons selling the contracts, such as agents or salespersons. Often, the provision specifies that this sole and/or exclusive authority is granted to the commissioner, notwithstanding any other law. Alternatively, the provision may expressly specify that the contracts or sellers are not subject to the securities act or to the securities commissioner.

The variable contract laws in eighty percent of the states have the exclusive jurisdiction provision. The variable contract laws in the remaining twenty percent of the states do not

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contain the exclusive jurisdiction language. Specifically, the exclusive jurisdiction language is present in the variable contract laws of forty states, including Hawaii. It is not present in the variable contract laws of the remaining ten states.

Our findings above are based primarily upon a reading of what we identified as the variable contract statutes of each of the fifty states. Table 5 beginning on the next page quotes verbatim the relevant statutory text of the several states with regard to the contract being regulated and the presence of the exclusive jurisdiction language. It also lists whether a state has enacted the model variable contract law or similar legislation. It also notes whether the exclusive jurisdiction language additionally makes references to other laws, specifically, the securities act of that state.

Incidentally, the variable contract laws of thirty-three of the fifty states are attributed to the model variable contract law, drafted by the National Association of Insurance Commissioners, or similar legislation. The variable contract laws of the remaining twenty-seven states are not attributed to the model law.¹

Finally, an issue arises with regard to whether insurance divisions get involved in enforcement activities in those states where variable annuities are not defined as "securities" under the securities acts. We asked this of the National Association of Insurance Commissioners, whose membership is composed of the insurance commissioners of the states. They were not able to provide any information on the matter. They do not track this particular kind of information and had no leads to provide. They commented that obtaining such information "sounds like an intense and time consuming legal research project."² Thus, the National Association of Insurance Commissioners has no information on whether such insurance divisions actually engage in enforcement activity relating to variable annuity contracts.

In contrast, the American Council of Life Insurers offers a different perspective, or spin, on the matter. Their statements apply to insurance commissioners in general, and not just commissioners in states whose securities acts do not apply to variable annuity contracts. The council states that insurance commissioners possess the capability to actually engage in enforcement activity. Specifically:

[I]nsurance commissioners have ample resources, expertise and statutory authority to comprehensively regulate the issuance and sale of variable life insurance and annuities. There has been no demonstration that the insurance commissioners are unable to vigorously regulate the issuance and sale of variable products, and to aggressively address any problems in the marketplace.³

Basically, the council seems to be implying that insurance commissioners have the capability to deal with sales practice abuses because they have not been shown not to have that capability.

¹ Model Variable Contract Law, Model Regulation Service, April 2005, October 2005, National Association of Insurance Commissioners.

² Correspondence from the Department of Commerce and Consumer Affairs, Insurance Division, to the Legislative Reference Bureau, October 19, 2006, reporting responses of researchers and attorneys with the National Association of Insurance Commissioners, in response to questions submitted to the division by the Bureau.

³ Life Insurers' Position on the Uniform Securities Act, American Council of Life Insurers, December 9, 2004, presented at the National Conference of State Legislatures Fall Forum 2004.

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References

State Variable Contracts Acts

Alabama	Code of Alabama, sections 27-38-1 to 27-38-6
Alaska	Alaska Statutes, section 21.42.370
Arizona	Arizona Revised Statutes, sections 20-651, 20-2601 to 20-2662
Arkansas	Arkansas Code, sections 23-81-401 to 23-81-405
California	California Insurance Code, sections 10506-10506.5
Colorado	Colorado Revised Statutes, sections 10-7-401 to 10-7-405
Connecticut	General Statutes of Connecticut, section 38a-433
Delaware	Delaware Code, title 18, section 2932
Florida	Florida Statutes, sections 627.801 to 627.807
Georgia	Unannotated Georgia Code, section 33-11-66
Hawaii	Hawaii Revised Statutes, section 431:10D-118
Idaho	Idaho Statutes, sections 41-1937 to 41-1940
Illinois	Illinois Compiled Statutes, 215 ILCS 5/245.21 to 215 ILCS 5/245.60
Indiana	Indiana Code, section 27-1-5-1(1)(c)
Iowa	Iowa Code, sections 508A.1 to 508A.5
Kansas	Kansas Statutes, sections 40-436 to 40-437
Kentucky	Kentucky Revised Statutes, section 304.15-390
Louisiana	Louisiana Revised Statutes, section 22:1500
Maine	Maine Revised Statutes, title 24-A, section 2537
Maryland	Maryland Code, Insurance article, sections 16-601 to 16-603
Massachusetts	Massachusetts General Laws, sections 175-132G to 175-132H
Michigan	Michigan Compiled Laws, sections 500.925, 500.4000
Minnesota	Minnesota Statutes, sections 61A.13 to 61A.21
Mississippi	Mississippi Code, sections 83-7-27 to 83-7-49
Missouri	Missouri Revised Statutes, section 376.309
Montana	Montana Code Annotated, sections 33-20-601 to 33-20-606
Nebraska	Nebraska Statutes, sections 44-2201 to 44-2221
Nevada	Nevada Revised Statutes, section 688A.390
New Hampshire	New Hampshire Revised Statutes Annotated, sections 408:27 to 408:63
New Jersey	New Jersey Permanent Statutes, sections 17B:28-1 to 17B:28-15
New Mexico	New Mexico Statutes Annotated, section 59A-20-30
New York	New York Consolidated Laws, insurance law, section 4240
North Carolina	North Carolina General Statutes, section 58-7-95
North Dakota	North Dakota Century Code, sections 26.1-33-13 to 26.1-33-17; 26.1-34-11
Ohio	Ohio Revised Code, section 3911.011
Oklahoma	Oklahoma Statutes, sections 36-6061 to 36-6062
Oregon	Oregon Revised Statutes, sections 731.156, 733.220, 733.230, 743.230, 743.245, 743.247
Pennsylvania	Unconsolidated Pennsylvania Statutes, title 40, section 506.2
Rhode Island	Rhode Island General Laws, sections 27-32-1 to 27-32-9
South Carolina	South Carolina Code of Laws, sections 38-67-10 to 38-67-50
South Dakota	South Dakota Codified Laws, sections 58-28-13 to 58-28-33
Tennessee	Tennessee Code, sections 56-3-501 to 56-3-509
Texas	Texas Statutes, insurance code, articles 1152.001 to 1152.204
Utah	Utah Code, section 31A-5-217 to 31A-5-217.5
Vermont	Vermont Statutes, title 8, sections 3855 to 3859

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Virginia	Code of Virginia, sections 38.2-3113 and 38.2-3114
Washington	Revised Code of Washington, sections 48.18A.010 to 48.18A.900
West Virginia	West Virginia Code, sections 33-13A-1 to 33-13A-5
Wisconsin	Wisconsin Statutes, sections 611.25, 620.02, 627.18, 632.45
Wyoming	Wyoming Statutes, section 26-16-502

Other

Model Variable Contract Law, Model Laws, Regulations and Guidelines, National Association of Insurance Commissioners, including model regulation service through October 2005.

Table 5. State Variable Contract Laws

State	NAIC Model Law	Contracts Regulated	Regulator	Exclusive Jurisdiction	Reference to Other Laws
Alabama	NAIC	Variable contracts AC 27-38-3 (a)	Commissioner of insurance AC 27-2-2, 27-2-7	Issuance and sale, licensing of persons selling the contracts AC 27-38-4	Notwithstanding any other provision of law AC 27-38-4
Alaska	NAIC	Variable contracts AS 21.42.370 (j)	Director, division of insurance, department of commerce, community, and economic development AS 21.06.010, 21.06.080 (a)	Issuance and sale, examine and license agents to sell the contracts AS 21.42.370 (k)	--
Arizona	Other	Variable contracts ARS 20-651 (H)	Director of insurance ARS 20-141, 20-142	Issuance and sale ARS 20-651 (I)	Notwithstanding any other law ARS 20-651 (I)
Arkansas	NAIC	Variable contracts AC 23-81-404 (a)	Insurance commissioner AC 23-61-103	Issuance and sale AC 23-81-405	Notwithstanding AC 23-81-405
California	NAIC	Contract providing for variable benefits CIC 10506 (h)	Insurance commissioner Ca Ins Code 1-48 (20), 12921 (a)	--	--
Colorado	NAIC	Variable contracts CRS 10-7-404 (1)	Commissioner of insurance CRS 10-1-103 (1), 10-1-104 (1)	Issuance and sale CRS 10-7-405 (1)	Notwithstanding any other provision of law CRS 10-7-405 (1)
Connecticut	NAIC	Contract [or annuity] providing benefits payable in variable amounts CGS 38a-433 (b), (c)	Insurance commissioner CGS 38a-1 (4), 38a-8	Annuities, sale, insurers CGS 38a-433 (c)	Annuities, sales, insurers not subject to the securities act CGS 38a-433 (c)

State	NAIC Model Law	Contracts Regulated	Regulator	Exclusive Jurisdiction	Reference to Other Laws
Delaware	NAIC	Variable contracts DC title 18, 2932 (c)	Insurance commissioner DC title 18, 301, 310	Issuance and sale DC title 18, 2932 (d)	Notwithstanding any other provision of law DC title 18, 2932 (d)
Florida	Other	Contract on a variable or indeterminate value basis FS 627.8055	Department of financial services and the office of insurance regulation of the financial services commission FS 624.05, 624.307	Issuance and sale of variable and indeterminate value contracts FS 627.805	Notwithstanding any other provision of law FS 627.805
Georgia	Other	Variable annuity contracts GC 33-11-66 (n)	Commissioner of insurance GC 33-2-1	Issuance and sale GC 33-11-66 (o)	Contracts, issuers, sellers subject to the securities act GC 33-11-66 (o)
Hawaii	NAIC	Variable contracts HRS 431:10D-118	Insurance commissioner HRS 431:2-102	Issuance and sale, licensing of sellers HRS 431:10D-118 (d)	Notwithstanding any other provision of law HRS 431:10D-118 (d)
Idaho	NAIC	Variable contracts IS 41-1938	Director of the department of insurance IS 40-202, 40-210	Issuance and sale, licensing of sellers IS 41-1939 (1)	Notwithstanding any other provision of law IS 41-1939 (1)
Illinois	NAIC	Variable contracts 215 ILCS 5/245.23	Director of insurance 215 ILCS 5/2 (a), 215 ILCS 5/401	Issuance and sale 215 ILCS 5/245.24	Notwithstanding any other provision of law 215 ILCS 5/245.24
Indiana	Other	Contracts providing for immediate or future life insurance and/or annuity benefits, fundable and/or computable as to cost or payment or both...out of or on the basis of assets in a segregated investment account IC 27-1-5-1 (c)	Insurance commissioner of the department of insurance IC 27-1-1-1, 27-1-1-2	--	--

State	NAIC Model Law	Contracts Regulated	Regulator	Exclusive Jurisdiction	Reference to Other Laws
Iowa	NAIC	Variable contracts IC 508A.3	Commissioner of insurance IC 505.1	Issuance and sale IC 508A.4	Notwithstanding any other provision of law IC 508A.4
Kansas	Other	Contracts in this state providing for payments which vary directly according to investment experience KS 40-436 (h), (i)	Commissioner of insurance KS 40-102	Issuance and sale KS 40-436 (l)	Contracts, issuers, sellers not subject to the securities act or to the securities commissioner KS 40-436 (l)
Kentucky	NAIC	Contract or agreement providing benefits in variable amounts KRS 304.15-390 (5)	Executive director of the office of insurance KRS 304.2-020 (1)	Issuance and sale KRS 304.15-390 (7)	--
Louisiana	NAIC	Contract providing benefits in variable amounts LRS 22:1500 (I)	Commissioner of insurance LRS 22:2 (A)	Issuance and sale LRS 22:1500 (J)	Contracts, issuers, sellers not subject to the securities act or to the securities commissioner LRS 22:1500 (J)
Maine	NAIC	Contract or agreement providing benefits in variable amounts MRS title 24-A 2537 (6)	Superintendent of insurance MRS title 24-A, 201	Issuance and sale of variable contracts MRS title 24-A 2537 (11)	Notwithstanding any other provision of law MRS title 24-A 2537 (11)
Maryland	Other	Individual and group variable annuity contracts that provide for payment varying directly with the investment experience of a segregated asset account MC, Insurance, 16-601 (a) (2)	Insurance commissioner MC, Insurance, 1-101 (k), 2-101	--	--

State	NAIC Model Law	Contracts Regulated	Regulator	Exclusive Jurisdiction	Reference to Other Laws
Massachusetts	Other	Contract on a variable basis MGL 175-132G	Commissioner of insurance MGL 175-1, 175-3A	--	--
Michigan	Other	Written agreement or a contract on a variable basis MCL 500.925 (1)	Commissioner of insurance MCL 500.200, 500.202	--	--
Minnesota	Other	Contracts on a variable basis MS 61A.19	Commissioner of commerce MS 60A.03	Issuance and sale, persons licensing of sellers MS 61A.20	Notwithstanding any other provision of law MS 61A.20
Mississippi	NAIC	Variable contracts MC 83-7-43	Commissioner of insurance MC 83-1-1, 83-1-3	Issuance and sale of contracts for which separate accounts may be established, issuers, sellers MC 83-7-45	Notwithstanding any other provision of law MC 83-7-45
Missouri	NAIC	Contract under which amounts are to be allocated to one or more separate accounts MRS 376.309.7	Director of the department of insurance MRS 374.010, 374.020	Issuance and sale MRS 376.309.6	Contracts, issuers, sellers not subject to securities act or to the securities commissioner MRS 376.309.6
Montana	NAIC	Variable contract MC 33-20-605 (1)	Commissioner of insurance MC 33-1-202 (1), 33-1-311	Issuance and sale MC 33-20-602	Except as provided in Title 30, chapter 10, parts 1 through 3, [the securities act] MC 33-20-602
Nebraska	Other	Variable annuities NRS 44-2201	Director of insurance NRS 44-101.01	--	--

State	NAIC Model Law	Contracts Regulated	Regulator	Exclusive Jurisdiction	Reference to Other Laws
Nevada	NAIC	Variable contracts NRS 688A.390 (3)	Commissioner of insurance NRS 679A.060, 679B.120	Issuance and sale NRS 688A.390 (4)	Notwithstanding any other provision of law NRS 688A.390 (4)
New Hampshire	Other	Variable contracts NHRS 408:28 (I)	Insurance commissioner NHRS 400-A:3	Issuance and sale, agents and employees NHRS 408:52 (II)	Notwithstanding any other provision of law NHRS 408:52 (II)
New Jersey	Other	Contract on a variable basis NJPS 17B:28-2	Commissioner of banking and insurance NJPS 17:1-1, 17:1-2	Issuance and sale of separate account contracts NJPS 17B:28-14	Separate account contracts, issuers, sellers not subject to the Uniform Securities Law NJPS 17B:28-14
New Mexico	NAIC	Variable contracts NMS 59A-20-30 (C)	Superintendent of insurance NMS 59A-1-12, 59A-2-8	Issuance and sale NMS 59A-20-30 (E)	Notwithstanding any other provision of law NMS 59A-20-30 (E)
New York	Other	Agreement in this state providing for the allocation of amounts to a separate account NYCL Ins Law 4240 (e)	Superintendent of insurance NYCL, Ins Law, 201	Issuance and sale of agreements relating to separate accounts NYCL Ins Law 4240 (d) (7)	Notwithstanding any other provision of law NYCL Ins Law 4240 (d) (7)
North Carolina	NAIC	Variable contract NCGS 58-7-95 (a), (q)	Commissioner of insurance NCGS 58-1-5 (2), 58-2-40	Issuance by life insurers, sale NCGS 58-7-95 (a), (r)	Contracts, issuers not subject to the securities law or to the secretary of state NCGS 58-7-95 (a), (r)
North Dakota	NAIC	Variable contracts NDCC 26.1-34-11	Insurance commissioner NDCC 26.1-01-01, 26.1-01-03	--	--
Ohio	Other	Policy, annuity, or other contract providing variable or fixed and variable benefits or contractual payments ORC 3911.011 (A)	Superintendent of insurance ORC 3901.011	Sale, delivery, issuance ORC 3911.011 (C)	Securities act does not apply to any variable contract issued by an authorized life insurer ORC 3911.011 (D)

State	NAIC Model Law	Contracts Regulated	Regulator	Exclusive Jurisdiction	Reference to Other Laws
Oklahoma	NAIC	Variable contract providing benefits in variable amounts OS 36-6061 (C)	Insurance commissioner OS 36-301, 36-307	Issuance and sale OS 36-6061 (D)	Contracts, issuers, sellers not subject to securities act or to the securities commissioner OS 36-6061 (D)
Oregon	NAIC	Variable life insurance; variable annuity ORS 731.156	Director of the department of consumer and business services ORS 731.236	--	--
Pennsylvania	NAIC	Variable contracts 40 PS 506.2 (c)	Insurance commissioner PS, title 40, 41, 42	Issuance and sale, contract provisions, annual statements, premiums, charges 40 PS 506.2 (d)	Notwithstanding any other provision of law + Contracts, sellers not subject to securities act or to the securities commission 40 PS 506.2 (d)
Rhode Island	NAIC	Agreement providing benefits in variable amounts RIGL 27-32-6	Director of the department of business regulation RIGL 42-14-5	Issuance and sale, licensing of sellers RIGL 27-32-7	Notwithstanding any other provisions of law RIGL 27-32-7
South Carolina	NAIC	Variable contracts SCCL 38-67-30	Director of the department of insurance SCCL 38-3-10	Issuance and sale SCCL 38-67-40	Notwithstanding any other provision of law SCCL 38-67-40
South Dakota	NAIC	Variable contracts SDCL 58-28-25	Director of the division of insurance SDCL 58-2-1.1, 58-2-2.1, 58-2-21	Issuance and sale SDCL 58-28-31	Securities division may require disclosure document filing. May also review underlying investments, if requested SDCL 58-28-31
Tennessee	NAIC	Agreement providing benefits in variable amounts TC 56-3-507	Commissioner of commerce and insurance TC 56-1-201	Issuance and sale, licensing of agents or salespersons TC 56-3-508	--

State	NAIC Model Law	Contracts Regulated	Regulator	Exclusive Jurisdiction	Reference to Other Laws
Texas	Other	Variable contract TS Ins 1152.102 (a)	Commissioner of insurance TS Ins 31.001, 31.002, 31.003	Issuance and sale TS Ins 1152.101	--
Utah	NAIC	Variable contracts UC 31A-5-217.5 (5)	Insurance commissioner of the insurance department UC 31A-2-101, 31A-2-102	Issuance and sale UC 31A-5-217.5 (6)	Notwithstanding any other provision of law UC 31A-5-217.5 (6)
Vermont	NAIC	Variable contracts VS title 8, 3857 (a)	Commissioner of banking, insurance, securities, and health care administration VS, title 8, 12	Issuance and sale VS title 8, 3858	Notwithstanding any other provision of law VS title 8, 3858
Virginia	Other	Variable life insurance or variable annuity contracts VC 38.2-3113 (C)	State corporation commission VC 38.2-100, 38.2-200	--	--
Washington	NAIC	Variable contracts WRC 48.18A.010, 48.18A.040	Insurance commissioner WRC 48.02.010, 48.02.060	Issuance and sale WRC 48.18A.070 But dual licensing of sellers recognized. Sellers must be life insurance agents or securities salesmen or brokers. WRC 48.18A.060	Notwithstanding any other provision of law + except for the examination, issuance or renewal, suspension or revocation, of a security salesman's license issued to persons selling variable contracts WRC 48.18A.070
West Virginia	NAIC	Variable contracts WVC 33-13A-3	Insurance commissioner WVC 33-1-5, 33-2-3	Issuance and sale WVC 33-13A-4	Notwithstanding any other provision of law WVC 33-13A-4

State	NAIC Model Law	Contracts Regulated	Regulator	Exclusive Jurisdiction	Reference to Other Laws
Wisconsin	Other	Contract providing life or annuity benefits in variable amounts WS 627.18	Commissioner of insurance WS 600.03(11), 601.41	--	--
Wyoming	NAIC	Variable contracts WS 26-16-502 (c)	Insurance commissioner WS 26-1-102 (a), 26-2-102	Issuance and sale WS 26-16-502 (d)	Notwithstanding any other provision of law WS 26-16-502 (d)

Chapter 7

CONTRASTING SECURITIES AND INSURANCE STATUTES

Introduction

This chapter provides a side-by-side contrast of each state's securities acts and insurance statutes, specifically the variable contract law in the insurance statutes, with regard to variable annuity contracts.

Findings

In comparing the securities acts alongside the variable contract laws of each state, a possible inconsistency between the two statutes may arise depending upon the classification of variable annuity contracts under the securities act and the presence of the exclusive jurisdiction language in the variable contract law. Under the securities acts of the states, a variable annuity contract is either a security or not a security. Correspondingly, under the variable contract law of the states, the exclusive jurisdiction provision is either present or absent. If it is present, then the issuance and sale of variable contracts are expressly placed under the exclusive jurisdiction of the insurance commissioner or regulator. Accordingly, there are four possible scenarios.

Scenario # 1 -- Variable annuity contracts are deemed not to be "securities" under the securities act. The variable contract law *does not contain* the exclusive jurisdiction provision. These states are California, Indiana, Maryland, Michigan, Nebraska, New Jersey, Oregon, Virginia, and Wisconsin. Under this scenario, no inconsistency in statutes appears to arise, as the statutes do not clash with each other.

Indiana is in this group. Indiana was singled out in the legislative resolution. Like the majority of states, Indiana has a securities act that does not apply to variable annuity contracts. However, like a minority of states, it has a variable contracts law that does not contain the exclusive jurisdiction provision.

With regard to how Indiana's law works in practice, we received feedback from the Indiana authorities on the administration of their laws. According to the Indiana chief deputy commissioner of securities, the securities division has a memorandum of understanding with the department of insurance, and the division lends help in investigating violations of the insurance statutes that concern variable annuity contracts.¹ The Indiana securities commissioner notes that the securities commissioner has a right to investigate complaints, but final disposition of cases belongs to the insurance commissioner. The securities commissioner emphasizes that he does not know if Indiana's current law will work in a real world context since Indiana has had no variable annuities cases at all for a couple years (aside from the Waddell & Reed multi-state

¹ Correspondence from the Indiana Office of the Secretary of State, Securities Division, September 12, 2006, in response to an inquiry from the Bureau.

settlement). The securities commissioner considers the Indiana structure to be sub-optimal but understands that his opinion is theoretical, since the law is untested.²

The Indiana insurance department states that that there seems to be some overlapping responsibilities and authority between the department and the securities division. Because of this overlap, both agencies had to sign the Waddell & Reed settlement agreement. The department adds that both agencies, however, work cooperatively with each other, and there are no problems caused by this arrangement. Finally, the department indicates that there were no recent changes to the insurance statutes in relation to annuities except for the enactment of the new chapter on recommendations to senior consumers, which became effective July 1, 2006³ (and which was discussed earlier in chapter 2).

Scenario # 2 -- Variable annuity contracts are deemed not to be "securities" under the securities act. The variable contract law *contains* the exclusive jurisdiction provision (for regulation as insurance). These states are Alabama, Alaska, Arkansas, Colorado, Connecticut, Delaware, Georgia, Idaho, Illinois, Iowa, Kansas, Louisiana, Maine, Minnesota, Mississippi, New Hampshire, New Mexico, North Carolina, Ohio, Oklahoma, Pennsylvania, South Carolina, Tennessee, Texas, Utah, West Virginia, and Wyoming. Under this second scenario, too, no inconsistency in statutes appears to arise, as the statutes do not clash with each other.

A large sub-group under scenario # 2 includes states in which the exclusive jurisdiction language of the variable contract law contains additional and clarifying preemptory language regarding the relationship of the variable contracts law to the securities act. The additional language typically specifies that the contracts, issuers, or agents are not subject to the securities act or to the jurisdiction of the securities commissioner. The language is not a part of the original model variable contract law.⁴ Specifically, states in this sub-group are Connecticut, Georgia, Kansas, Louisiana, North Carolina, Ohio, Oklahoma, and Pennsylvania.

Scenario # 3 -- Variable annuity contracts are deemed to be "securities" under the securities act. The variable contract law does not contain the exclusive jurisdiction provision. These states are Massachusetts and North Dakota. Under this scenario, an overlap in jurisdiction is possible between the securities commissioner and the insurance commissioner. Whether the possibility in overlap also makes for an inconsistency in statutes is not known.

Scenario # 4 -- Variable annuity contracts are deemed to be "securities" under the securities act. The variable contract law contains the exclusive jurisdiction provision. These states are Arizona, Florida, Hawaii, Kentucky, Missouri, Montana, Nevada, New York, Rhode Island, South Dakota, Vermont, and Washington. Under this scenario, there appears to be an inconsistency between the two statutes. Despite the exclusive jurisdiction language in the variable contracts law, variable annuity contracts are nonetheless securities under the securities

² Correspondence from the Department of Commerce and Consumer Affairs, Business Registration Division, reporting the division's communications with the Indiana Securities Commissioner, to the Legislative Reference Bureau, December 15, 2006, in response to a request from the Bureau.

³ Correspondence from the Indiana Department of Insurance, Consumer Protection Division, December 27, in response to an inquiry from the Bureau.

⁴ Model Variable Contract Law, Model Regulation Service, April 1999, National Association of Insurance Commissioners.

act. In other words, persons engaged in the selling of those contracts are potentially subject to the jurisdiction of the securities commissioner.

A few states in scenario # 4 have additional language in the exclusive jurisdiction language of their variable contract law that addresses the applicability of the securities act. This language is not a part of the original model variable contracts law.⁵ Specifically, these states are Montana, South Dakota, and Washington.

In the Montana variable contract law, the text specifies that the insurance commissioner's sole authority to regulate the issuance and sale of variable contracts is granted to the commissioner except as provided in the securities act. Also, the legislative history of the law, as expressed in the law's accompanying "statement of intent," indicates that the scope of the insurance commissioner's rulemaking authority is limited to maintaining of reserves, valuation of assets, intra-company transfers of cash and securities, and requirements of doing business.⁶

In the South Dakota variable contract law, the securities division may require filings of disclosure documents with the division. The securities division may also review the underlying investments in securities of variable contracts, if requested by the insurance division.

In the Washington variable contract law, the insurance commissioner's sole and exclusive authority to regulate the issuance and sale of variable contracts is inapplicable to the licensing of a security salesman who sells variable contracts. Licensure of the security salesman is done pursuant to the securities act. The Washington securities act authorizes a dual licensing framework such that a person selling a variable contract must be licensed either as a life insurance agent under the insurance code or as a security salesman or securities broker under the securities act.⁷

Table 6 provides in more detail a break down of each state's securities act and variable contract statute with regard to variable annuity contracts.

Table 6. State Securities and Insurance Statutes Compared

State	Securities Act	Variable Contracts Law	
	Status Of A Variable Annuity	Insurance Regulator's Authority	Statutory Reference To Securities Act
Alabama	Not a security	Sole authority	--
Alaska	Not a security	Sole authority	--
Arizona	Security	Sole authority	--
Arkansas	Not a security	Sole authority	--
California	Not a security	--	--
Colorado	Not a security	Sole authority	--

⁵ Model Variable Contract Law, Model Regulation Service, April 1999, National Association of Insurance Commissioners.

⁶ Montana Code Annotated section 33-20-602, Compiler's Comments.

⁷ Revised Code of Washington, section 21.20.03(7).

VARIABLE ANNUITY CONTRACTS UNDER STATE STATUTES
RELATING TO SECURITIES AND TO INSURANCE

State	Securities Act	Variable Contracts Law	
	Status Of A Variable Annuity	Insurance Regulator's Authority	Statutory Reference To Securities Act
Connecticut	Not a security	Sole authority	Expressly preempts securities regulation over contracts and insurance companies
Delaware	Not a security	Sole authority	--
Florida	Security	Sole authority	--
Georgia	Not a security	Sole authority	Expressly preempts securities regulation over contracts, issuers, agents in the sale of the contracts
Hawaii	Security	Sole authority	--
Idaho	Not a security	Sole authority	--
Illinois	Not a security	Sole authority	--
Indiana	Not a security	--	--
Iowa	Not a security	Sole authority	--
Kansas	Not a security	Sole authority	Expressly preempts securities regulation over contracts, issuing companies, agents
Kentucky	Security	Sole authority	--
Louisiana	Not a security	Sole authority	Expressly preempts securities regulation over contracts, issuing companies, agents
Maine	Not a security	Sole authority	--
Maryland	Not a security	--	--
Massachusetts	Security	--	--
Michigan	Not a security	--	--
Minnesota	Not a security	Sole authority	--
Mississippi	Not a security	Sole authority	--
Missouri	Security	Sole authority	Expressly preempts securities regulation over contracts, issuers, agents
Montana	Security	Sole authority	Expressly preserves securities regulation
Nebraska	Not a security	--	--
Nevada	Security	Sole authority	--
New Hampshire	Not a security	Sole authority	--
New Jersey	Not a security	--	--
New Mexico	Not a security	Sole authority	--
New York	Security	Sole authority	--
North Carolina	Not a security	Sole authority	Expressly preempts securities regulation over contracts, issuers
North Dakota	Security	--	--
Ohio	Not a security	Sole authority	Expressly preempts securities regulation over contracts
Oklahoma	Not a security	Sole authority	Expressly preempts securities regulation over contracts, issuers, agents

CONTRASTING SECURITIES AND INSURANCE STATUTES

State	Securities Act	Variable Contracts Law	
	Status Of A Variable Annuity	Insurance Regulator's Authority	Statutory Reference To Securities Act
Oregon	Not a security	--	--
Pennsylvania	Not a security	Sole authority	Expressly preempts securities regulation over contracts and agents
Rhode Island	Security	Sole authority	--
South Carolina	Not a security	Sole authority	--
South Dakota	Security	Sole authority	Expressly preserves limited securities regulation over investments and disclosures
Tennessee	Not a security	Sole authority	--
Texas	Not a security	Sole authority	--
Utah	Not a security	Sole authority	--
Vermont	Security	Sole authority	--
Virginia	Not a security	--	--
Washington	Security	Sole authority	Expressly preserves securities regulation over licensing of security salesmen
West Virginia	Not a security	Sole authority	--
Wisconsin	Not a security	--	--
Wyoming	Not a security	Sole authority	--

Chapter 8

OTHER SURVEYS

This chapter briefly discusses past surveys on the status of variable annuity contracts under state securities acts.

Blue Sky Regulation

A survey is included in the multi-volume treatise, *Blue Sky Regulation, Second Edition*, by Robert N. Rapp, published by LexisNexis. Its date is unclear. In section 7.05, entitled "Insurance Company Securities," the author looks at the securities acts of all fifty states and points out whether exclusions and exemptions apply for insurance products. The insurance products that he looks at are insurance policies, endowments, and annuities. The annuities that he looks at are both fixed annuities and variable annuities.

First, he looks at whether any exclusions are found in the definition of "security" such that whatever is excluded is therefore outside the scope of the securities act. Second, he then looks at whether any exclusions cover insurance products. Third, he then looks at securities issued by insurance companies. Because these insurance company securities are first and foremost securities, they are not excluded from the scope of the act. Here, he looks at whether these insurance company securities are exempt from registration under the act. Fourth, he looks at exemptions for insurance company securities to determine whether the exemption is further qualified by the nature of governmental control over the insurance company. Specifically, he looks at whether the insurance company must be authorized to do business in the state, must be under the control of a specific state agency, or whether it is permissible for the insurance company to simply be authorized under the laws of any state.

No totals are provided. The reader must count them up himself from the charts. With regard to the statutory definition of "security," it appears then that thirty-five of the fifty states exclude insurance endowments and fixed annuities. Thirty-two of the fifty states exclude variable annuities of insurers. One of the fifty includes variable annuities. Eight of the fifty have no exclusions for securities.

With regard to the exemption from registration for securities, five of the fifty states have exemptions that apply to insurance endowments and annuities only. Twenty-one of the fifty have exemptions that apply to all insurance company securities. Nineteen of the fifty have no exemption provisions.

For Hawaii, he notes that the definition of "securities" excludes insurance endowments and fixed annuities. In his text, he indicates that the definition includes variable annuities. In his accompanying chart, though, this fact is overlooked. An "X" is missing in the space that signifies that variable annuities are included in the definition of "security." In any case, he adds that the exemption for insurance company securities applies to all insurance company securities,

not just insurance endowments and annuities. Finally, he points out that for the registration exemption to apply, the insurer must be authorized to do business in the State.

North American Securities Administrators Association, Inc.

The North American Securities Administrators Association, Inc., prepared an article entitled "Functional Regulation in the 21st Century: What's Reasonable for Investor Protection and for Agents Selling Variable Annuities?" It was evidently published in the spring 2003 issue of *The Journal of Investment Compliance*. The article includes a state survey compiled by the NASAA Variable Annuities Project Group and entitled "Non-uniformity in the Functional Regulation of Agents Selling Variable Annuities." It was updated as of September 3, 2002. The survey covers all fifty states plus the District of Columbia and territory of Puerto Rico, for a total of fifty-two jurisdictions.

The survey lays out information extracted from both the securities acts and the insurance codes of the fifty-two jurisdictions. The survey focuses on variable annuities. It compares regulatory features governing variable annuities under both the securities acts and the insurance codes. For the securities acts, the survey notes two things. One is whether the definition of "security" has an exclusion or has no exclusion for variable annuities. The second is whether insurance agents who sell variable products need a state securities license. For the insurance code, the survey notes whether the variable contracts law has the provision that grants "exclusive jurisdiction" over variable products to the insurance commissioner. Finally, the survey notes whether the regulatory structure of a jurisdiction is such that the securities division and insurance division are the same entity or subject to the same appointing authority.

The totals are provided in the footnotes to the survey. The survey finds, first of all, that a total of seventeen of the fifty-two jurisdictions do not exclude variable annuities from the definition of "security." Of these seventeen, eight jurisdictions only exclude fixed annuity contracts. One state (Hawaii) includes variable annuities but excludes variable life insurance and fixed annuity contracts. Two states have no exclusion for any type of insurance, endowment, or annuity contracts. Six states have no exclusion of any kind.

Secondly, the survey finds that at least fourteen of the fifty-two jurisdictions require agents to have a state securities license in order to sell variable products.

Third, the survey finds that seven of the fifty-two jurisdictions do not appear to have the "exclusive jurisdiction" language. Of these seven jurisdictions, two specifically recognize the jurisdiction of the securities administrator to regulate insurance agents.

Fourth, the survey finds that in fourteen of the fifty-two jurisdictions, the regulatory structures for the securities and insurance divisions are related.

For Hawaii, the survey notes that the securities act has no exclusion for variable annuities. It also indicates that the securities act does not require insurance agents to have a securities license in order to sell variable products. With regard to the insurance code, the survey

points out that the variable contracts law has the exclusive jurisdiction language. Finally, the survey indicates that the securities and insurance divisions are either the same entity or have the same appointing authority, specifically, "Commerce & Consumer Affairs."

(We note that the director of commerce and consumer affairs is the same appointing authority for both the securities commissioner¹ and the insurance commissioner.²)

American Council of Life Insurers

The American Council of Life Insurers prepared a life insurance law survey entitled "The Status of Variable Contracts under State Securities and Insurance Laws." The June 2005 version is evidently an updated version of a survey included as part of their December 9, 2004, statement presented to the National Conference of State Legislatures, Fall Forum 2004. The June 2005 survey covers all fifty states plus the District of Columbia and the territories of Guam and Puerto Rico, for a total of fifty-three jurisdictions.

The survey basically tracks two items. First, it looks at the variable contracts law in the insurance code to see if the law grants the insurance commissioner exclusive jurisdiction to regulate variable contracts. Second, it looks at the securities act to see if the definition of "security" provides a complete exclusion for all insurance, endowment, and annuity contracts. (There is a third item in the survey on parallel exclusions, but its purpose is unclear, and the entries in the table are mostly blank.)

The numerical summary that accompanies the survey indicates that forty-seven of the fifty-three jurisdictions grant the insurance commissioner exclusive jurisdiction to regulate the issuance and sale of variable annuities and variable life insurance contracts. Thirty-three of the fifty-three jurisdictions exclude all insurance, endowment, and annuity contracts from the definition of "security" in the state securities codes. Nine of the fifty-three jurisdictions specifically define variable annuity and variable life insurance contracts as a "security" in the state securities codes. Five of the fifty-three jurisdictions exclude no categories of any kind from the definition of "securities" in the state securities codes. Finally, two of the fifty-three jurisdictions have no exclusion from the definition of "security" for any type of insurance, endowment, or annuity contract.

For Hawaii, the updated 2005 version of the survey notes that the variable contracts law contains the exclusive jurisdiction language. For the securities act, the entry relating to exclusions from the definition of "security" is left blank. Instead, there is a footnote in the entry indicating that: "Definition of "security" in Hawaii does not include any insurance or endowment policy or fixed *annuity* contract. Variable *life* insurance, therefore, is excluded from definition." No inferences are made in the footnote about variable *annuity* contracts, even though the survey is about variable contracts, which include both variable annuity contracts and variable life insurance. However, an accompanying map to the survey, entitled "Status of Variable Life Insurance and Variable Annuities under State Securities Laws" shows Hawaii as

¹ Hawaii Revised Statutes section 485-2 (a).

² Hawaii Revised Statutes section 431:2-102 (a).

being a state that "excludes *all* insurance, endowment, and annuity contracts from definition of security. The inference then is made in the map that variable annuity contracts are among the annuity contracts excluded from the definition of "security." This is an erroneous inference.

Out of curiosity we looked at the earlier 2004 version of the survey. Everything reported there for Hawaii is identical or substantially identical with the 2005 version. The text of the footnote is identical. The title of the accompanying map is substantially identical. It is entitled "Status of Variable Contracts under State Securities Laws." However, the demographics of the map are different. The earlier map shows Hawaii as being a state that "excludes insurance, endowment, or annuity contracts from the definition of security." The inference is that one or more but not necessarily all three products are excluded. Thus, in the 2004 survey, Hawaii is not presented as a state that "excludes *all* insurance, endowment, and annuity contracts from the definition of security." But in the 2005 survey, Hawaii is so presented as a state that "excludes *all* insurance, endowment, and annuity contracts from the definition of security."

We are unaware of any changes in Hawaii law between 2004 and 2005 to justify a revised interpretation of the exclusions to the definition of "security" in the securities act. Perhaps the map in the updated 2005 version of the survey simply contains an inadvertent clerical error.

In any case, the insurance commissioner also had an opportunity to review the council's material. The commissioner indicated that he had:

[C]oncerns about the accuracy of the state-by-state statistics provided by the American Council of Life Insurers (ACLI) regarding which states define annuities as securities and which states do not. In this regard, just because a state fails to define a variable annuity contract as a security, does not necessarily mean that the state does not regulate variable annuities as securities. Hawaii is a case in point. The ACLI includes Hawaii among the states that exclude all annuity contracts from the definition of security, the inference being that in Hawaii, variable annuities are only regulated as insurance. However, this inference is inaccurate. Clearly, Hawaii law provides the Securities Commissioner with oversight over variable annuity contract sales practices, along with the ability to respond to customer complaints and take appropriate enforcement actions, including the award of restitution.³

³ Correspondence from the Department of Commerce and Consumer Affairs, Insurance Division, to the Legislative Reference Bureau, October 19, 2006, in response to questions submitted by the Bureau.

Chapter 9

FINDINGS

The Bureau makes the following findings:

A variable annuity contract is a contract between a purchaser and an insurer. The purchaser makes either a single purchase payment or a series of purchase payments. The insurer agrees to make periodic payments to the purchaser beginning either immediately or at some future date. The contract offers investment options, which are typically mutual funds. Money may be transferred from one investment option to another within the annuity without paying a tax at the time of the transfer. Furthermore, no taxes are paid on the income and investment gains from the annuity until money is withdrawn. Earnings are then taxed at ordinary income tax rates and not the lower capital gains rates.

The variable annuity contract is a hybrid investment containing both securities and insurance features. The securities feature of variable annuities provides the investor with an opportunity to participate in potential capital appreciation and income through investments in the securities markets. However, the securities feature also subjects the investor to market risks. The insurance feature of variable annuities permits the investor to receive a series of periodic payments from the investment over time. It also provides a death benefit to the beneficiary if the investor dies during the accumulation phase and the account value is less than the "basis" (principal plus gains) at the time of death.¹

There has been widespread negative publicity and concerns over the overzealous marketing and inappropriate sales of variable annuity contracts to consumers, in particular senior consumers and consumers approaching retirement.

Sales practice abuses associated with variable annuity contracts include churning, failures to make disclosures, inadequate training, lack of supervision, living trust mills, market timing schemes, unauthorized trades, unsuitable variable product recommendations, unsuitable switching or replacement, violations of books and records requirements.

Abuses can relate to the principle of suitability. The principle of suitability requires that a broker-dealer recommending a variable product to an investor must assess the investor's financial status, investment objectives, and other relevant information to determine if the product is suitable. The obligation to recommend only securities that are suitable for the customer arises from the antifraud provisions of the federal securities laws and from rules of the self-regulatory organizations. A broker-dealer must have a reasonable basis for believing that the securities recommendations are suitable for the customer in light of the customer's financial needs, objectives, and circumstances.

¹ "Variable Annuities--Facts and Fiction", February 2005, North American Securities Administrators Association.

FINDINGS

The Hawaii securities commissioner states that removing variable annuity contracts from the securities act will open up a gap in enforcement over sales practice abuses relating to variable annuity contracts.

Under the federal Securities Act of 1933, variable annuity contracts are deemed to be securities, and not to be insurance, according to the United States Supreme Court in its 1959 opinion, *S.E.C. v. Variable Annuity Co.*, 359 U.S. 65 (1959). The holding remains valid to the present. But it does not constitute a mandate to the states regarding the status of variable annuity contracts under state securities acts.

The federal McCarran-Ferguson Act recognizes that the "business of insurance" shall be regulated by the states and protects such state regulation from being preempted by federal legislation that is not specifically related to the "business of insurance."

Hawaii has a Uniform Securities Act. Under the present version and the new version that takes effect in 2008, the term "security" is expressly defined to include a "variable annuity contract." Accordingly, both acts apply to variable annuity contracts. Defining a variable annuity contract to be a security gives the securities commissioner jurisdiction over sales practice abuses relating to variable annuity contracts.

Hawaii has a variable contracts law in the insurance code. The law applies to variable annuity contracts. The law also has an exclusive jurisdiction provision, under which the insurance commissioner has the sole and exclusive authority over the issuance and sale of variable contracts, including the licensing of persons selling variable contracts, notwithstanding any other provision of law.

When it was added to the insurance code for the first time in 1969, the variable contracts law contained the exclusive jurisdiction language. A clarifying amendment was made at that time to the securities act in order to exclude any annuity contract, including a variable annuity contract, from the scope of the securities act. However, in 1984 the securities act was amended to expressly include variable annuity contracts in the definition of "security," and the exclusion in the definition was amended to only apply to a fixed annuity contract.

The insurance commissioner and the securities commissioner have their respective jurisdictions over the product, the issuers, the persons involved in the sale of the product, and sales practices. Specifically, the insurance commissioner oversees insurers, the contract itself, and salespersons. The securities commissioner oversees broker-dealers, salespersons, and sales practice abuses. There are presently no gaps in enforcement. There is concurrent enforcement over salespersons.

Between insurance and securities, suitability issues are the realm of securities, not insurance. Suitability relates to the duty of the broker to recommend to a customer only those securities that are suitable to the investment objectives and peculiar needs of that particular customer.

VARIABLE ANNUITY CONTRACTS UNDER STATE STATUTES
RELATING TO SECURITIES AND TO INSURANCE

All fifty states have securities acts. These acts may or may not apply to variable annuity contracts, depending on whether the definition of "security" in the securities act is deemed to include or exclude a variable annuity contract.

The securities acts in thirty-six states do not appear to apply to variable annuity contracts. The securities acts in the remaining fourteen states do appear to apply to variable annuity contracts. We base these conclusions on one of four approaches used in understanding other states' securities acts:

- (1) Communications from the securities commissioners or like entities;
- (2) Evidence of enforcement actions under the securities acts relating to variable annuity contracts;
- (3) Interpretation of the definition of "security" based on the official code comments to the three versions of the Uniform Securities Acts; and
- (4) Interpretation of the definition of "security" in context with the provision on exempt securities.

All fifty states have variable contract laws in their insurance codes. These laws apply to variable annuity contracts.

The variable contract laws in forty states have an exclusive jurisdiction provision. The variable contract laws in the remaining ten states do not. Under the exclusive jurisdiction provision, the insurance commissioner has the sole authority, the exclusive authority, or the sole and exclusive authority, over the issuance and sale of the variable contracts. Often, this authority is granted to the commissioner, notwithstanding any other law. Alternatively, the provision may expressly specify that the contracts or sellers are not subject to the securities act or to the securities commissioner. However, there are some states in which the exclusive jurisdiction language expressly preserves applicability of the securities act over variable contracts.

The combination of variable contract laws and securities acts present four possible scenarios:

- (1) Variable annuity contracts are deemed not to be "securities" under the securities act. The variable contract law *does not contain* the exclusive jurisdiction provision. Under this scenario, no inconsistency in statutes appears to arise, as the statutes do not clash with each other.
- (2) Variable annuity contracts are deemed not to be "securities" under the securities act. The variable contract law *contains* the exclusive jurisdiction provision. Under this second scenario, too, no inconsistency in statutes appears to arise, as the statutes do not directly clash with each other.

FINDINGS

- (3) Variable annuity contracts are deemed to be "securities" under the securities act. The variable contract law *does not contain* the exclusive jurisdiction provision. Under this scenario, an overlap in jurisdiction is possible between the securities commissioner and the insurance commissioner. Whether the possibility of an overlap also makes for an inconsistency between statutes is not known.
- (4) Variable annuity contracts are deemed to be "securities" under the securities act. The variable contract law *contains* the exclusive jurisdiction provision. Under this scenario, there appears to be an inconsistency between the two statutes. Despite the exclusive jurisdiction language in the variable contracts law, variable annuity contracts are nonetheless securities under the securities act.

Indiana, the state that was singled out in the concurrent resolution, is in the first scenario. At the administrative level, the Indiana securities division has a memorandum of understanding with the department of insurance. The division assists the department in investigating violations of the insurance statutes that concern variable annuity contracts. While the securities division has a right to investigate complaints, final disposition belongs to the insurance department. The Indiana law is untested, as Indiana has not had any variable annuity cases for the past couple of years. However, the securities commissioner believes that the structure is suboptimal.

According to the Indiana department of insurance, there seems to be some overlapping responsibilities and authority between the department and the securities division. However, both agencies work cooperatively with each other, and there are no problems caused by this arrangement.

If the Legislature wants to clarify the present status quo in Hawaii law under which both the securities commissioner and the insurance commissioner have concurrent jurisdiction over variable annuity contracts, the Legislature can repeal the exclusive jurisdiction language in the variable contracts law. Alternatively, the Legislature could amend the exclusive jurisdiction language so as to specify that the securities act is applicable to variable contracts.

Other studies on the status of variable annuity contracts under state securities acts have been done by author Robert N. Rapp, the North American Securities Administrators Association, and the American Council of Life Insurers. With regard to Hawaii law, the findings of Robert N. Rapp and the North American Securities Administrators Association are consistent with our own. Those of the American Council of Life Insurers are not.

SENATE CONCURRENT RESOLUTION

REQUESTING THE LEGISLATIVE REFERENCE BUREAU TO CONDUCT A STUDY
ON THE ISSUE OF RECLASSIFYING VARIABLE ANNUITY CONTRACTS AS
INSURANCE RATHER THAN SECURITIES.

1 WHEREAS, a variable annuity contract is a tax-deferred
2 investment that typically invests in stock and bond mutual funds
3 that provide the investor with an opportunity for potential
4 capital appreciation and income but also subjects the investor
5 to market risks and is primarily sold by insurance companies;
6 and

7
8 WHEREAS, the insurance features of variable annuity
9 contracts permit the investor to receive a series of periodic
10 payments from the investment over the life of the contract and
11 provide a death benefit to the beneficiary should the investor
12 die during the accumulation phase; and

13
14 WHEREAS, while these products are legitimate investments,
15 regulators are concerned about overzealous marketing of variable
16 annuity contracts, especially to senior consumers who require
17 particular protection from the risks involved in these
18 instruments; and

19
20 WHEREAS, variable annuity contracts are generally thought
21 to be inappropriate for seniors unless they are fully informed
22 of the risks involved, such as short-term market movements given
23 that seniors generally cannot afford a long investing horizon,
24 and the restrictions involved, such as steep penalties for early
25 withdrawals, which may hamper seniors' access to their funds;
26 and

27
28 WHEREAS, there has been widespread publicity concerning
29 inappropriate sales of variable annuity contracts to the general
30 public, especially seniors and those approaching retirement, to
31 hold these annuities inside a 401(k) retirement account or
32 Individual Retirement Account, when the buyer would already be
33 getting tax-deferred growth in an Individual Retirement Account

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1 or a 401(k) account, and the variable annuity simply adds an
2 additional layer of cost with no additional tax benefit; and
3

4 WHEREAS, some of the complaints regarding the sales of
5 variable annuities include:

6
7 (1) Misleading advertising;

8
9 (2) Unsuitable recommendations;

10
11 (3) Switching and churning of customer accounts to
12 increase sales commissions; and
13

14 (4) Failure to disclose fees and other important
15 characteristics of these contracts; and
16

17 WHEREAS, there is uncertainty over the most effective means
18 of regulating sales of variable annuity contracts; and
19

20 WHEREAS, according to the National Association of
21 Securities Dealers, which was established under authority
22 granted by the Securities Exchange Act of 1934, and which
23 regulates almost 5,200 securities firms employing more than
24 663,000 registered securities professionals, the sales-related
25 problems of variable annuity contracts parallel those of mutual
26 funds and other securities and the National Association of
27 Securities Dealers believe that "it is incongruous for agents
28 and sales practices involved in variable [annuity] contracts not
29 to be covered by state securities laws"; and
30

31 WHEREAS, it was reported by the North American Securities
32 Administrators Association, which was organized in 1919 and is a
33 voluntary association whose goal is investor protection, that
34 the Securities Enforcement Branch of the Department of Commerce
35 and Consumer Affairs is currently investigating fourteen
36 enforcement cases regarding variable annuities contracts
37 involving thirty-one consumers; and
38

39 WHEREAS, the North American Securities Administrators
40 Association continually lists variable annuity contracts in its
41 "Top Ten Investment Scams" annually; and
42

1 WHEREAS, the American Council of Life Insurers, a national
2 trade association that is composed of three hundred seventy-
3 seven member companies, pointed out that the continued inclusion
4 of variable annuity contracts as a security in Hawaii would:

- 5
6 (1) Perpetuate an additional layer of unnecessary and
7 duplicative regulation;
8
9 (2) Perpetuate existing conflict between the insurance and
10 securities regulators and create an uncertain
11 regulatory environment for life insurers and others
12 who sell variable annuity contracts; and
13
14 (3) Conflict with existing law that the Council says
15 confers exclusive authority to regulate variable
16 annuity contracts to the Insurance Commissioner; and
17

18 WHEREAS, the American Council of Life Insurers states that,
19 in response to widely publicized complaints from consumers
20 dealing with unsuitable annuity sales, particularly to seniors
21 due to their age and penalty charges assessed upon early
22 withdrawal or surrender, in 2003, the National Association of
23 Insurance Commissioners adopted two models of insurance
24 regulation, namely, the Annuity Disclosure Model Regulation and
25 the Senior Protection in Annuity Transactions Model Regulation;
26 and
27

28 WHEREAS, S.B. No. 3070, 2006, was introduced during the
29 Regular Session of 2006 to delete "variable annuity contracts"
30 from the definition of "security" thus removing variable annuity
31 contracts from securities regulation; and
32

33 WHEREAS, S.B. No. 2225, 2006, was introduced during the
34 Regular Session of 2006 to require insurers and insurance
35 providers to make reasonable efforts to obtain relevant
36 information from senior consumers prior to conducting annuities
37 transactions; and
38

39 WHEREAS, the Legislature understands that some
40 jurisdictions, the State of Indiana among them, regulate sales
41 of variable annuities as insurance rather than as securities;
42 now, therefore,
43

1 BE IT RESOLVED by the Senate of the Twenty-third
2 Legislature of the State of Hawaii, Regular Session of 2006, the
3 House of Representatives concurring, that the Legislative
4 Reference Bureau is requested to examine how other states, such
5 as Indiana, are addressing the issue of reclassifying a variable
6 annuity contract as insurance rather than as a security; and
7

8 BE IT FURTHER RESOLVED that the Director of Commerce and
9 Consumer Affairs, the Insurance Commissioner, and the
10 Commissioner of the Business Registration Division are requested
11 to assist and fully cooperate with the Legislative Reference
12 Bureau in the conduct of the study; and
13

14 BE IT FURTHER RESOLVED that the Legislative Reference
15 Bureau is requested to submit its report to the Legislature no
16 later than twenty days prior to the convening of the Regular
17 Session of 2007; and
18

19 BE IT FURTHER RESOLVED that certified copies of this
20 Concurrent Resolution be transmitted to the Director of Commerce
21 and Consumer Affairs, the Insurance Commissioner, the
22 Commissioner of the Business Registration Division, and the
23 Director of the Legislative Reference Bureau.
24
25
26

OFFERED BY: _____

Appendix B

GLOSSARY OF TERMS

Listed below are definitions of terms (and names) appearing in this report. The definitions of some terms were provided by the Business Registration Division and the Insurance Division of the Department of Commerce and Consumer Affairs. Others were excerpted from Barron's Dictionary of Insurance Terms, Fourth Edition; Barron's Dictionary of Finance and Investment Terms, Seventh Edition; and Internet encyclopedia, Wikipedia.

American Council of Life Insurance. An association of life insurance companies focusing on legislation and public relations that may affect the life insurance business on federal, state, and local levels. Membership is composed of both stock and mutual life insurance companies. The council lobbies to voice the views of the life insurance business in order to influence public opinion and legislation.¹

Annuity. A contract sold by an insurance company designed to provide payments to the holder at specified intervals, usually after retirement. The holders are taxed only when they start taking distributions or if they withdraw funds from the account. All annuities are tax-deferred, meaning that the earnings from investments in these accounts grow tax-deferred until withdrawal. Annuity earnings are also tax-deferred so they cannot be withdrawn without penalty until a certain specified age. Fixed annuities guarantee a certain payment amount, while variable annuities do not, but do have the potential for greater returns. An annuity has a death benefit equivalent to the higher of the current value of the annuity or the amount the buyer has paid into it. If the owner dies during the accumulation phase, his or her heirs will receive the accumulated amount in the annuity. This money is subject to ordinary income taxes in addition to estate taxes.²

Annuity business. The term "annuity business," which is used in the model variable contract law, possibly refers to an insurance company affiliate that issues annuity contracts or to the annuity portion of an insurance company's business.³

Endowment insurance. Life insurance under which an insured receives the face value of a policy if the individual survives the endowment period. If the insured does not survive, a beneficiary receives the face value of the policy. An endowment policy is the most expensive type of life insurance.⁴

Fixed annuity. An investment vehicle offered by an insurance company that guarantees a stream of fixed payments over the life of the annuity. A fixed annuity is a long-term savings tool created, marketed, and sold by insurance companies. Funds invested in a fixed annuity are deposited in the insurer's general account and receive interest. The interest rate may fluctuate

¹ Barron's Dictionary of Insurance Terms, Fourth Edition.

² Correspondence from the Department of Commerce and Consumer Affairs, Business Registration Division, November 8, 2006, in response to an inquiry to the division from the Bureau, October 31, 2006.

³ Correspondence from the Department of Commerce and Consumer Affairs, Insurance Division, to the Legislative Reference Bureau, October 19, 2006, in response to questions submitted by the Bureau.

⁴ Barron's Dictionary of Insurance Terms, Fourth Edition.

with market conditions, but the principal is guaranteed based upon the safety and soundness of the insurer. The insurer, not the insured, takes the investment risk. The annuity will have certain "insurance-type" functions available to the owner. This includes the ability to exchange the account value for a stream of income.

Fixed annuities offer a guaranteed rate of interest over a specified time, or term of the annuity. With traditional fixed annuities, the insurance company invests your premium in its general account. Whatever payout option you select, the interest gains and payment amounts are guaranteed by the insurance company, which assumes the risk of investing the general account.⁵

Insurance. As pointed out in *Appleman on Insurance, 2d.*, as a practical matter, there is neither a universally accepted definition or concept of "insurance" nor an exclusive concept or definition that can be pervasively applied. In this regard, *Appleman* explains:

[I]n our intricate and evolving commercial and social intercourse, it seems appropriate that any concept and meaning of insurance be sufficiently broad and flexible to meet the varying and innovative transactions which humankind perpetually produces. [*Appleman on Insurance, 2d.*, §1.3, p. 10.]

Thus, in determining what is insurance, an evaluation of the transaction's social and economic implications is usually necessary. Additionally, a court must consider the contract in its entirety, giving effect to all of its provisions in the light of the intentions of the parties. While no one characteristic is determinative of the nature of insurance, the following are among the essential characteristics considered:

- **Risk is the Mother Mold of insurance and risk sharing is the keystone to the nature of insurance.** [*Appleman, supra.*] It is characteristic of insurance that a number of risks are accepted, some of which will involve losses, and that such losses are spread over all the risks in a way that enables the insurer to accept each risk at a slight fraction of the possible liability upon it. [*Couch on Insurance, 3d.*, §1:9, p. 1-16.] Through the sharing of risks, insurance is designed to fulfill the reasonable expectations and needs of four varying interests – the insurer, the insured, other insured policyholders, and the payee who is often a third-party beneficiary or a claimant. [*Appleman, supra.*]
- **Insurance is a matter of contract.** The primary character of an insurance contract is indemnity. Thus, the party insured is entitled to compensation for such loss as has been occasioned by the perils insured against, the right to recover being commensurate with (1) the loss sustained, or (2) the amount contractually specified, as in cases of life insurance and valued policies. [*Couch, supra*, §1:10, p. 1-18.]
- **An insurance contract requires an insurable interest.** "Insurable interest" means that interest that the law requires a person making an insurance contract to have in the property or person insured. [*Appleman, supra*, §1.3, p.14.]

⁵ Correspondence from the Department of Commerce and Consumer Affairs, Business Registration Division, November 8, 2006, in response to an inquiry to the division from the Bureau, October 31, 2006.

Additionally, a contract of insurance is by nature:

- **Aleatory**, in the sense that it depends upon some contingent, fortuitous event. Accordingly, the insurer will not and should not be asked to provide coverage for a loss that is reasonably certain or expected to occur within the policy period. Further, an insurer is not required to respond to claims strictly within the control of the insured, such as a claim arising from the intentional acts of the insured.
- **Voluntary**, in that parties, as long as they act in good faith, may incorporate such provisions and conditions as they choose and are thereafter bound by all such provisions unless they are prohibited by positive law or public policy;
- **Executory**, in the limited sense that, with respect to the insurer, it is not executed until the payment of a sum after loss;
- **Conditional**, in a number of aspects, including: (1) the need to comply with conditions precedent; (2) the need for a loss to fall within the contract's terms, as to covered perils; and (3) the need for the subject, such as property, to be located in a designated place in order for protection to be afforded; and
- **Personal**, in that the contract between the insurer and the insured is a personal contract between an insuring entity and the insured and not the object being insured. In other words, the question of whether payment is due upon the occurrence of a contingency, and how such payment will be measured, depends upon economic loss suffered by the insured. [*Couch, supra*, §1-10, p.1-19.]

A working test to determine what is insurance. Whatever the form it takes or the name it bears, courts generally will find any contract having the following five elements to be a contract of insurance in the traditional sense:

- The insured possesses an interest of some kind susceptible to pecuniary estimation, also known as an insurable interest;
- The insured is subject to a risk of loss through the destruction or impairment of the insurable interest by the happening of certain designated fortuitous perils [today generally called the insured event];
- The insurer assumes that risk of loss [which today we describe as risk transference];
- The insurer assumes that risk as part of a general scheme to distribute actual losses among a large group bearing somewhat similar risks; and

- As consideration for the insurer's promise to assume the risk of loss, the insured makes a contribution (called a premium) to the general insurance fund. [*Appleman, supra*, §1.4, p. 22.]⁶

Know your customer. Ethical concept in the securities industry either stated or implied by the rules of the exchanges and the other authorities regulating broker-dealer practices. Its meaning is expressed in the following paragraph from Article 3 of the NASD Rules of Fair Practice: "In recommending to a customer the purchase, sale or exchange of any security, a member shall have reasonable grounds for believing that the recommendation is suitable to such customer upon the basis of the facts, if any, disclosed by such customer as to his other security holdings and as to his financial situation and needs." Customers opening accounts at brokerage firms must supply financial information that satisfies the know your customer requirement for routine purposes.⁷

Life insurance. Life insurance is protection against the death of an individual in the form of payment to a beneficiary--usually a family member, business, or institution. In exchange for a series of premium payments or a single premium payment, upon the death of an insured, the face value (and any additional coverage attached to a policy), minus outstanding policy loans and interest, is paid to the beneficiary.⁸

Mutual fund. Fund operated by an investment company that raises money from shareholders and invests it in stocks, bonds, options, futures, currencies, or money market securities. These funds offer investors the advantages of diversification and professional management. Mutual fund shares are redeemable on demand at net asset value by shareholders. All shareholders share equally in the gains and losses generated by the fund.⁹

National Association of Insurance Commissioners. Membership organization of state insurance commissioners. One of its goals is to promote uniformity of state regulation and legislation as it concerns the insurance industry. The NAIC opposes federal regulation of insurance.¹⁰

National Association of Securities Dealers. Nonprofit organization formed under the joint sponsorship of the Investment Bankers' Conference and the Securities and Exchange Commission to comply with the Maloney Act. NASD members include virtually all investment banking houses and firms dealing in the over the counter market. Operating under the supervision of the Securities and Exchange Commission, the NASD's basic purpose are to (1) standardize practices in the field, (2) establish high moral and ethical standards in securities trading, (3) provide a representative body to consult with the government and investors on

⁶ Correspondence from the Department of Commerce and Consumer Affairs, Insurance Division, November 20, 2006, in response to an inquiry originally directed to the Business Registration Division from the Bureau, October 31, 2006.

⁷ Barron's Dictionary of Finance and Investment Terms, Seventh Edition.

⁸ Barron's Dictionary of Insurance Terms, Fourth Edition.

⁹ Dictionary of Finance and Investment Terms, Seventh Edition.

¹⁰ Barron's Dictionary of Insurance Terms, Fourth Edition.

matters of common interest, (4) establish and enforce fair and equitable rules of securities trading, and (5) establish a disciplinary body capable of enforcing the above provisions.¹¹

North American Securities Administrators Association. Organized in 1919, NASAA is a voluntary association whose membership consists of 67 state, provincial, and territorial securities administrators in the 50 states, the District of Columbia, Puerto Rico, the U.S. Virgin Islands, Canada, and Mexico. Members license firms and their agents, investigate violations of state and provincial law, file enforcement actions, and educate the public about investment fraud.¹²

National Conference of Commissioners on Uniform State Laws. The National Conference of Commissioners on Uniform State Laws is a non-profit unincorporated association in the United States that consists of commissioners appointed by each state and territory. The purpose of the association is to discuss and debate in which areas of law there should be uniformity among the states and to draft acts accordingly. The results of these discussions are proposed to the states as either model acts or uniform acts. NCCUSL is best known for its work on the Uniform Commercial Code.¹³

Securities and Exchange Commission. Federal agency created by the Securities Exchange Act of 1934 to administer that act and the Securities Act of 1933, formerly carried out by the Federal Trade Commission. The statutes administered by the Securities and Exchange Commission are designed to promote full public disclosure and protect the investing public against malpractice in the securities markets.¹⁴

Security. An investment instrument, other than an insurance policy or fixed annuity, issued by a corporation, government, or other organization that offers evidence of debt or equity. The official definition, from the Securities Exchange Act of 1934, is: "Any note, stock, treasury stock, bond, debenture, certificate of interest or participation in any profit-sharing agreement or in any oil, gas, or other mineral royalty or lease, any collateral trust certificate, preorganization certificate or subscription, transferable share, investment contract, voting-trust certificate, certificate of deposit, for a security, any put, call, straddle, option, or privilege on any security, certificate of deposit, or group or index of securities (including any interest therein or based on the value thereof), or any put, call, straddle, option, or privilege entered into on a national securities exchange relating to foreign currency, or in general, any instrument commonly known as a 'security'; or any certificate of interest or participation in, temporary or interim certificate for, receipt for, or warrant or right to subscribe to or purchase, any of the foregoing; but shall not include currency or any note, draft, bill of exchange, or banker's acceptance which has a maturity at the time of issuance of not exceeding nine months, exclusive of days of grace, or any renewal thereof the maturity of which is likewise limited."¹⁵

¹¹ Barron's Dictionary of Finance and Investment Terms, Seventh Edition.

¹² *Ibid.*

¹³ Wikipedia, at <http://en.wikipedia.org>.

¹⁴ Barron's Dictionary of Finance and Investment Terms, Seventh Edition.

¹⁵ Correspondence from the Department of Commerce and Consumer Affairs, Business Registration Division, November 8, 2006, in response to an inquiry to the division from the Bureau, October 31, 2006.

Separate account. Professionally managed portfolio of securities that uses pooled money to buy investments owned directly by the account holder. Separate accounts are usually marketed by broker-dealers, who select money managers for clients from a selected list. The chief advantage of separate accounts over mutual funds is direct ownership of securities in the portfolio. This permits customization and provides individual cost basis for income tax purposes. The investor, unlike a mutual fund investor, thus has control of the tax consequences of the timing of purchases and realized profit or loss.¹⁶

Suitability rules. Guidelines that those selling sophisticated and potentially risky financial products, such as limited partnerships or commodities futures contracts, must follow to ensure that investors have the financial means to assume the risks involved. Such rules are enforced through self-regulation administered by such organizations as the National Association of Securities Dealers, the securities and commodities exchanges, and other groups operating in the securities industry. Individual brokerage firms selling the products have their own guidelines and policies. They typically require the investor to have a certain level of net worth and liquid assets, so that he or she will not be irreparably harmed if the investment sours. A brokerage firm may be sued if it has allowed an unsuitable investor to buy an investment that goes sour. See also **Know your customer.**¹⁷

Variable annuity. A variable annuity is one in which the investor has the option to invest their funds in a set of mutual fund-like accounts referred to as "sub-accounts." By federal law, variable annuities are deemed securities and subject to federal securities laws. They are registered with the Securities and Exchange Commission and must be sold through NASD registered broker-dealers by NASD registered representatives (securities salespersons). The investors' account value is NOT in the insurers general account and therefore not guaranteed. With variable annuities, however, your premiums buy units in your choice of separate accounts, which then invest in stocks, bonds, and money market funds. Your payout will depend on the performance of the underlying securities in the separate accounts in which your premium is invested. Unlike fixed annuities, the value of your account is not guaranteed -- you assume the risk involved in investing your premiums in exchange for potentially higher returns. While fixed annuities are clearly insurance products because the insurer bears all of the risk, variable annuities are more closely related to securities as the owner/investor retains a majority of the risk. Further, it must be understood that insurers created variable annuities in order to stem the loss of assets to mutual funds as they gained in popularity and thus "invented" a product that was designed to blur the lines between insurance and securities. The result is that of a hybrid product that requires two sets of specialized knowledge to properly regulate. This "functional regulation" requires that securities experts (the Securities Division and SEC/NASD) regulate the suitability, supervision, and sales practices while the rates and forms and other "insurance" aspects are regulated by insurance experts (insurance division). As one can see, there is no more overlap here than in any other regulated area that crosses the lines.¹⁸

¹⁶ Barron's Dictionary of Finance and Investment Terms, Seventh Edition.

¹⁷ *Ibid.*

¹⁸ Correspondence from the Department of Commerce and Consumer Affairs, Business Registration Division, November 8, 2006, in response to an inquiry to the division from the Bureau, October 31, 2006.

Variable life insurance. Investment-oriented whole life insurance policy that provides a return linked to an underlying portfolio of securities. The portfolio typically is a group of mutual funds established by the insurer as a separate account, with the policyholder given some investment discretion in choosing the mix of assets among, say, a common fund, a bond fund, and a money market fund. Variable life insurance offers fixed premiums and a minimum death benefit. The better the total return on the investment portfolio, the higher the death benefit or surrender value of the variable life policy.¹⁹

¹⁹ Barron's Dictionary of Insurance Terms, Fourth Edition.