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Via Electronic Filing

Florence E. Harmon
Acting Secretary
United States Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

RE: Release Nos. 33-8933, 34-58022; File No. S7-14-08

Dear Ms. Harmon:

Thank you for the opportunity to comment on the above-referenced rule proposal (the "Rule Proposal") to add section 230.151A (the "Definition Rule") and 240.12h-7 (the "Exemption Rule") to title 17, Chapter II, of the Code of Federal Regulations (collectively the "Proposed Rules") to define certain Equity Indexed Annuity contracts and certain other indexed annuity and optional annuity contracts (collectively "EIA") as securities under the Securities Act of 1933 and the Securities Exchange Act of 1934 (the "Securities Acts"). The Cornell Securities Law Clinic (the "Clinic") is a Cornell Law School curricular offering in which law students provide representation to public investors and public education as to investment fraud in the largely rural "Southern Tier" region of upstate New York. *See* http://securities.lawschool.cornell.edu.

As set forth below, (1) the Clinic strongly supports the Rule Proposal which we believe strengthens investor protection while striking a balance with the procedural needs of EIA issuers; and (2) the Clinic strongly opposes the requests by certain commentators for an extension of the comment period.

A. There is a Need for Regulation of Equity Indexed Annuities

First and foremost, there is an urgent need for regulation of EIAs for two related reasons. First, there is uncertainty as to whether or not EIAs constitute securities under current federal regulations.[1] The Supreme Court has looked to the assumption of

[1] *See, e.g.,* NASD, Equity-Indexed Annuities, Notice to Members 05-50 (Aug. 2005), http://www.finra.org/web/groups/rules_regs/documents/notice_to_members/p014821.pdf ("The question of whether a particular EIA is an insurance product or a security is

investment risk and the way in which the contract is marketed in determining whether a contract is in fact a security.[2] However, this judicial guidance does not sufficiently resolve whether or not an EIA is a security or an insurance contract, creating uncertainty in the market place, and allowing unscrupulous practices to flourish.[3]

Second, as documented in the Rule Proposal, there have been widespread sales practice abuses associated with the sales of EIAs. EIA sales growth has risen dramatically. Currently, there is more than $120 billion invested in EIA contracts.[4] However, the growth in sales has been accompanied by growth in sales abuses, particularly against senior citizens. In Massachusetts and Hawaii over 60 percent of all complaints by senior citizens to state securities regulators involved the purchase of EIAs.[5] In one case brought against a seller of EIAs, the court provided a description of the abuses surrounding the sales of EIAs:

> "The standardized sales process for the [EIA] involves an agent meeting with an elderly prospective purchaser, establishing a relationship of trust and confidence, then give an incomplete and misleading description about the product…Since the agents are merely conduits of information, they are unable to dispense an appropriate level of information about the product to the customers, so the customers cannot be sufficiently informed about what they are purchasing… As incentive to enlist its network of agent, Defendant offers extremely high commissions which are not disclosed to the prospective purchasers at the time of sale. By offering strong financial incentives to maximize sales, Defendant has fostered the use of high pressure and deceptive sales tactics."[6]

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complicated and depends upon the particular facts and circumstances concerning the instrument offered or sold."); Bureau of National Affairs, Inc. Banking Report. Vol 90. No. 26, 1210 ("Abusive sales practices have continued, [Chairman of the SEC, Christopher Cox] said, because the question of whether [EIAs] are securities 'has gone unchecked'.")

[2] *See*, *SEC v. Variable Annuity Life Ins. Co.*, 359 U.S. 65 (1959) ("VALIC"); *SEC v. United Benefit Life Ins. Co.*, 387 U.S. 202 (1967) ("United Benefit")

[3] *E.g.,* NASD, Equity-Indexed Annuities, Notice to Members, *supra* note 1. ("Many firms assume that EIAs that are not registered under the Securities Act are insurance products and not securities.").

[4] Bureau of National Affairs, Inc. Banking Report, *supra* note 1.

[5] *Id.*

[6] *Strube v. American Equity Investment Life Ins. Co.*, 226 F.R.D. 688 (M.D. Fla. 2005), at 691-92.

EIAs are complicated products with complex features that can confuse even experienced investment professionals.[7] Yet sales of EIAs often include misleading, if not false, disclosures including the ability to easily access and withdraw funds, the ability to realize all gains associated from any rise in the specific equity index, and the fact that there are no 'up-front' sales charges.[8] Such practices overstate the merits of EIAs as appropriate investments for participating in equity market returns without equity market risk. The reality is that EIAs do not offer a 'free lunch' but merely offer a minimal and unimpressive upside potential with downside protection that comes at significant cost in the form of fees and limited access to invested capital.[9]

Comments posted on the SEC's website demonstrate the misunderstandings surrounding EIA features. One commentator against the Rule Proposal, who bought an EIA from a relative, inaccurately believes that EIAs are commission free: "I understand the agent makes a commission, and why shouldn't he, *especially if it does not come from my original investment*."[10] (Emphasis added.) This investor completely misunderstands the nature of EIA compensation, and obviously was misled into believing that the insurance company pays the salesperson's commission. In fact, the high commissions associated with EIAs are paid from the original investment through lock-ups on invested capital, participation rates significantly below 100%, and fees associated with early withdrawals. One study estimates that between 15% and 20% of the purchase price is a 'transfer of wealth from unsophisticated investors to insurance companies and their sales forces."[11] The fact that an opponent of the Rule Proposal in fact is an unwitting victim of a misleading sales pitch, demonstrates the need for SEC action.

B. The Rule Proposal Adequately Addresses the Need for Regulation

The Clinic would have preferred even stronger regulation of EIAs than is proposed in the Rule Proposal. Nonetheless, the Clinic strongly supports the Rule Proposal, which attempts to strike a balance between the need for investor protection and the procedural needs of EIA issuers. The Rule Proposal does address the concerns we have expressed above by offering clarity regarding the legal status of EIAs and by

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[7] *See* McCann, Craig and Dengpan Luo, *An Overview of Equity-Indexed Annuities*, 2006 Securities Litigation and Consulting Group, Inc, http://www.slcg.com/pdf/workingpapers/EIA%20Working%20Paper.pdf at 2 ("[EIA] complexity makes it virtually impossible even for brokers and agents to properly evaluate the annuities.")

[8] *Strube*, 226 F.R.D. 688 at 692.

[9] McCann, Craig *An Overview of Equity-Indexed Annuities*.

[10] Comment Letter of Sam Lang, http://www.sec.gov/comments/s7-14-08/s71408-314.htm

[11] McCann, Craig, *An Overview of Equity-Indexed Annuities*.

subjecting EIA sales to regulatory oversight designed to curb abusive sales practices through application of suitability, fair dealing, and anti-fraud requirements.[12]

We strongly urge the SEC to approve the Rule Proposal and enact the Proposed Rule as soon as possible. The Proposed Rules are not unfair to the EIA industry. There are weaknesses in the Proposed Rules which we would have preferred be strengthened. These shortcomings highlight the fact that the Proposed Rules are balanced.

First, the Proposed Rules may not be sufficiently broad to offer the clarity needed to cover all EIA products. Because the Proposed Rules only apply to those contracts for which the amounts payable under the contract are 'more likely than not to exceed the amounts guaranteed' the Proposed Rules, the Proposed Rules cover only those contracts which *actually* shift a sufficient amount of the investment risk over to the purchaser. The Proposed Rules do not cover those contracts which are marketed in a way as to lead an investor to believe he is participating in the equities market. United Benefit seems to suggest that this broader approach may be more appropriate. In United Benefit, the Court found that a contract was outside the Section 3(a)(8) exemption, noting that the contract was 'considered to appeal to the purchaser not only on the usual insurance basis of stability and security but on the prospect of 'growth' through sound investment management".[13] Elsewhere the Court noted that the test to use in determining whether a contract is an investment contract is "what character the instrument is given in commerce by the terms of the offer, the plan of distribution, and the economic inducements held out to the prospect."[14] Thus it may be irrelevant whether or not the EIA actually will more likely than not pay out more than the guaranteed minimum so long as the contract was marketed and purchased with the reasonable expectation of equity market participation. By choosing a narrower reach, the SEC did not go as far as it could have in regulating EIAs.

Second, the Proposed Rules are not ideal in providing a clear methodology to calculate whether or not a contract is in fact more likely than not to pay more than the guaranteed minimum. The proposed regulation requires that an issuer of an EIA use reasonable assumptions with materially accurate statistics in determining whether or not a contract is more likely than not going to pay more than the guaranteed minimum. Once

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[13] See NASD Rule 2310, Recommendations to Customers (Suitability) and IM-2310-2 Fair Dealing with Customers, *available at* http://finra.complinet.com/finra/display/display.html?rbid=1189&element_id=1159000466. *See also* Dewey & LeBoeuf, *SEC Proposes New Rule to Bring Equity Indexed Annuities under SEC's Jurisdiction, (July 8, 2008), http://www.deweyleboeuf.com/files/News/9b544deb-86ce-4885-b6e9-0028ca888aaf/Presentation/NewsAttachment/9a9532db-6c79-4921-9ec3-00bb5a6d6cdc/SEC%20Proposes%20New%20Rule.pdf.*

[13] *United Benefit*, 387 US at 211.

[14] *Id.*

again, we would have preferred a bright line test that any EIA marketed with reference to the equity markets fall under the Proposed Rules.

Third, we would have preferred a shorter effective date of the Proposed Rules. The Proposed Rules currently have an effective date of 12 months from publication in the Federal Register. Statistics on the growth of EIA sales on a year to year basis suggest that a substantial number of EIA contracts would be sold in the interim under the conditions the Proposed Rules are meant to fix. Likely sales of EIAs during 12 month period may exceed $25 billion.[15] Even if only a small percentage are sold as a result of abusive sales practices or misinformation, the total sales could be significant. Again, we would have preferred a shorter effective date, but we understand the SEC wanted to give the EIA industry time to adjust.

Despite our concern that the SEC did not go far enough, the Proposed Rules are a positive step toward addressing serious concerns regarding the sales of EIAs. While the Clinic would have preferred even stronger regulation, the Rule Proposal strikes a reasonable balance and should be approved as soon as possible.

C. The Proposed Rules Impose Minimal Relative Burdens

We recognize that the Proposed Rules will impose some compliance costs on the EIA industry. Nonetheless, these costs are minimal relative to the gains to investors in regulatory oversight designed to curb abusive sales practices and to ensure that the product purchased is suitable to the needs of a particular investor.

The EIA industry may experience a transformation as EIA sales are shifted to new and existing broker-dealer networks. Many of the largest EIA issuers are affiliated with existing broker-dealer networks and thus already have the infrastructure and experience necessary to facilitate this transition. The benefits of uniform federal investor protection regulations more than offset any costs associated with a possible reduction in the access potential customers by requiring that EIAs be sold through licensed broker-dealers and salespersons. Given the widespread access to licensed professionals, such burdens on investors are minimal.

D. The Clinic Opposes Extension of the Comment Period

Certain commentators have requested an extension of the comment period. Extending the comment period will only serve to prolong the period during which EIAs are not subject to necessary regulation, and is unjustified given how long the substance of the Rule Proposal has been under consideration.

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[15] *See* NAVA, *2008 Annuity Fact Book* (2008), at 57.

Conclusion

The Proposed Rules adequately, if not ideally, address serious concerns with regard to the marketing and sales of EIAs. The Clinic strongly supports the Rule Proposal, and urges the SEC to approve the Rule Proposal without delay.

Respectfully submitted,

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