SECURITIES AND EXCHANGE COMMISSION
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REMARKS OF

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SECURITIES AND EXCHANGE COMMISSION

Before the

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Its Effect Upon Insurance"

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I am very pleased to be with you today and to have the opportunity to talk to you about your industry and its impact upon various sectors of the national interest. I must remind you at the outset, however, that the views I express are my own and do not necessarily reflect those of the Securities and Exchange Commission.

One measure of the economic power of the insurance industry has recently been obtained via the Institutional Investor Study now being conducted by the Securities and Exchange Commission at the direction of the Congress. The Study's mandate, most simply stated, is to study the impact of institutional investors of all types, including insurance companies, on the nation's securities markets, corporate issuers and the general economy. The study of the insurance industry was facilitated by the fact that it is highly concentrated, with 50 percent of total assets being held by only seven insurers. This meant that the Study was able to focus its attention on relatively few companies. Surveys of these companies revealed they held $161 billion in general account assets, $3.3 billion in separate account assets and 96 percent of total industry group annuity reserves.

The Study spotlights again one of the significant trends in the increasing diversification practiced by insurance companies, i.e., the sponsorship of equity investments through variable annuity separate accounts or similar endeavors.

This trend is a response to competitive pressure and completely understandable. At the same time, you must understand that when you diversify your insurance operations to include variable annuities and separate accounts, you subject yourself to further regulation. To be more specific, you come under the watchful eye of the Securities and Exchange Commission, which is responsible for administering the various Acts of Congress designed to regulate the securities markets and protect the investing public.

I'll also tell you right now that this isn't something the Commission wanted -- we had enough work to do before the insurance companies placed a segment of their business under Federal jurisdiction.

I'm also sure you're not overcome with joy at having us looking over your shoulders. So I doubt very much that our shotgun marriage will ever turn into a love match, but we're going to be bedfellows for a long time and we might just as well get used to each other. I'll try to contribute to this today by telling you the way it is from our viewpoint.

I know that insurance people think of variable annuity contracts as insurance policies. I also know that regulation of separate accounts in various states is accomplished largely by insurance departments. This might seem to make Federal regulation unnecessary, undesirable, and downright illegal -- and if this were so, I'd be smart enough to stay away today.

I'm sure most of you remember, however, the now famous S.E.C. v. Variable Annuity Life Insurance Company case. In that case the Supreme Court found that the variable annuity contracts being offered were securities which required registration under the Securities Act of 1933, and required a segment of the selling insurance company to register as an investment company under the Investment Company Act of 1940.

So the SEC is definitely in the act and I can stand before you, not altogether fearlessly, today. And I also think this is the ideal time to emphasize that to the extent it is possible and practical, the Commission does not want to get into the regulation of purely insurance features.

What's more, it is obvious that both the industry and the Commission have to make certain accommodations. On our part, we cannot view the variable separate account in the exact same light as a mutual fund -- it is not. On the other hand, the industry must not view the variable annuity contract purely as an insurance policy, for it is much more. It is an investment contract, and therefore a security.

Securities can be offered for sale only in compliance with existing law. This means that the investment features of variable annuity plans must be described in securities terms.

For example, the Commission insists that the person purchasing the contract be described as an investor or purchaser, and not as a policyholder. The Commission will not allow installment purchases to be described as premium payments. Nor will it normally allow you to use the term, "cash surrender value," when what is meant is redemption value.

The Commission further views the separate account as an investment company apart from the insurance company, with its own board of supervisors, its own investment policies, and its own general policies distinct from those of the insurance company. We view the contract holders -- the investors -- more in the light of shareholders, at least with respect to those rights that the Investment Company Act specifically grants to shareholders of investment companies. These rights include voting for the board of supervisors, voting to change fundamental investment policies, and most important, voting for the continuation of the investment advisory contract, even though the investment adviser may be, and almost always is, the insurance company which sponsored the separate account.

As I have said before, the Commission does not want to extend its jurisdiction any further than already exists, unless it is forced to by new practices emerging within the industry. An example of our dilemma recently appeared on the scene in the form of a combination contract which purportedly offers a purchaser the opportunity to divide his money between fixed-dollar and variable annuities. Unfortunately, these combination contracts so intertwine the rights of the investor in the variable annuity that it becomes almost impossible not to view the whole contract as an investment contract.

This is particularly significant because it forces us to consider whether fixed-dollar annuities should be regarded exclusively as insurance, or whether, in some instances, as part of a security package.

My brief comments on combined accounts should give you some inkling of why securities, unlike other forms of commerce, have long been regarded as "intricate merchandise." This fact has special significance for insurance companies because the line of demarcation between the sale of an insurance policy and the sale of a security is not always very clear, and in fact, can frequently become quite blurred. Furthermore,

when the nature of what is being sold is in doubt, the manner in which it is sold can be the determining factor. The Supreme Court has made clear that "it is not inappropriate that promoters' offerings be judged as being what they were represented to be." This should be remembered by those few companies who sell insurance with the use of promotional material that would make a carnival hustler blush. If a company offers life insurance it should be sold as such. On the other hand, if securities are in fact being sold, the "so called" insurance sales are subject to the antifraud provisions of the securities laws.

One further word relating to sales of investment contracts. The Commission has been challenged with the argument from time to time that since a particular contract has been cleared by the insurance commissioners of 50 states, it would be inordinately expensive to change it, even though it has since been found to be in conflict with the Investment Company Act. I can only advise you to touch base with us early in the game. Otherwise you may unwittingly place the Commission and various insurance departments in a difficult, but not unsoluble, position. I hope you will follow this advice because we cannot grant an exemption from the Investment Company Act solely because the product has been approved by an insurance department charged with administering only insurance laws.

Another aspect of the Investment Company Act which may present problems for the unwary is the fiduciary concept which is so much a part of that Act. Let me illustrate this by stating that my understanding is that regulation in the insurance industry by the various state insurance departments is aimed at preserving the reserve, or if you will, asset values of insurance companies, so that when policies mature or when claims are made, there will be no question that the undertakings of the insurance company will be met -- and met expeditiously. The concept of regulation under the Investment Company Act, however, is entirely different -- regardless of whether an orthodox investment company or a separate account is involved. As I said, fiduciary concepts are involved whereby the separate account is viewed as a trust and its officers, directors and other affiliated persons are viewed as trustees.

One of the Act's most important provisions makes it unlawful for an affiliated person or an underwriter of an investment company, acting as principal,

> to sell any security or property to the investment company,
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> to purchase any securities or property from a registered investment company,
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> or to borrow money or other property from such investment company.

Now what does this mean to your industry and the separate account? In most instances the insurance company is one or all of the following: it is the investment adviser, the underwriter, the promoter, or controlling person of the separate account; and, therefore is an affiliated person of the separate account.

Consequently, the "general account" of the insurance company with extremely few exceptions cannot purchase from or sell to the "separate account" any securities or property unless it receives an exemption from the Commission. Before the exemption is granted, the Commission must find that the terms of the proposed transaction are fair and reasonable and do not involve overreaching on the part of any person concerned.

Moreover, the Commission must find that the proposed transaction is consistent with the stated policies of the "separate account" and is also consistent with the general purposes of the Investment Company Act.

Even when a purchase or sale is prima facie fair an application for exemption must be filed with the Commission and granted before such transaction takes place. Anyone having anything to do with separate accounts should be aware of this part of the statute.

There is also a prohibition against any affiliated person or underwriter of an investment company participating in or effecting any transaction in connection with any joint

enterprise or joint arrangement or profit-sharing plan in which the registered investment company is a participant -- unless an application has been filed with the Commission and has been granted by an order.

Let me illustrate what I am talking about. Assume the existence of a large block of securities which the separate account could purchase at 2 or 3 points below the market, for a total of $500,000. The president of the insurance company, who is also an affiliate of the insurance company by definition, decides that he would like to participate in the transactions, so he has the separate account purchase $475,000 worth of shares and he buys the other $25,000 worth, thereby using the purchasing power of the separate account to obtain a bargain which he alone could not obtain.

The picture becomes more complicated if it is decided by overall management that the separate account could use the entire block of securities, the general account could also use the entire block, and ditto for a pension fund for key employees of the insurance company. And so the insurance company decides in order to be fair that the block selling for 2 to 3 points below the market should be divided among the three participants, approximately in equal proportions. According to management there is no desire to give any particular advantage to any of the three entities. However, there are grounds to believe that this is a joint arrangement, and without at least an exemption violates the 1940 Act.

If management, in an attempt to stay within the law, eliminates the separate account from consideration, has it acted correctly? -- or has the separate account been deprived of something akin to a corporate opportunity? These are very difficult questions to answer. Therefore, a word of caution -- When you are dealing in this area, proceed with extreme care.

I wonder how many of you are aware of how closely the SEC and the various State Insurance Departments work on mutual problems. For instance, our staff and the National Association of Insurance Commissioners have recently cooperated to remove over-the-counter securities from the uniform valuation guide book because their presence there had contributed to the sale of questionable securities to insurance companies.

The Commission and the State Insurance Departments have also coordinated their efforts in prosecuting persons engaged in looting the assets of insurance companies. I should add, the SEC becomes involved only when the securities laws are clearly violated and usually at the request of a State Insurance Department.

Perhaps you would like to know of our current concern in this area. The basic embezzlement scheme has taken a variety of patterns, but in essence, it boils down to a looting of the assets of the insurance company, usually securities, with the result that policyholders are often left without any resources to pay their claims. Part of the tragedy stems from the fact that many of these schemes could not have been carried out without the cooperation, and, in some cases, assistance of legitimate business interests who were not always aware of what was really being perpetrated.

A frequent pattern is for individuals of questionable background to contract to acquire control of an insurance company, often using the assets of that company to pay the purchase price. In at least one instance the acquisition has been followed by a liquidation of the insurance company's portfolio of securities, the embezzlement of the proceeds by insiders and the substitution of stolen or restricted securities in the portfolio. When such activities come to light, law enforcement agencies attempt to move quickly in order to put an end to them and to prosecute those responsible. However, your cooperation is essential. You should be on the alert to possible danger signs, which, if recognized in time, can help to forestall the illegal activity in the first place.

By this time I am sure you are aware that the administration of securities laws designed to protect the public is an extremely complex and time-consuming task. If I have seemed to point again and again at the pitfalls to be avoided where the sales of securities are involved, it is not with the hand of the accuser, but with the hand of one who would like nothing better than to help you to continue to skirt needless entanglement with statutes enacted for the common good. No one is more aware than I am of the enormous contribution the insurance industry has made to the growth of our country and to the welfare of its people. I wish you continued success in the future and I assure you of my willingness to be of help to you whenever I can.