ATTACHMENT ONE-A

STATEMENT OF THE
AMERICAN COUNCIL OF LIFE INSURANCE
BEFORE THE
NASAA/NAIC JOINT REGULATORY INSURANCE
PRODUCTS STUDY COMMITTEE

August 31, 1981

On behalf of its 525 member life insurance companies the American Council of Life Insurance (the "Council") is pleased to have this opportunity to present its views on the continuing inquiry into the regulation of so-called nontraditional insurance products being conducted by the NASAA/NAIC Joint Regulatory Insurance Products Study Committee (the "Joint Study Committee").

The Joint Study Committee was established in 1980 ". . . to review and make recommendations concerning possible areas of overlapping jurisdiction in enforcement of securities and insurance laws."[1] As the Joint Study Committee moved ahead with this project, its focus began to shift from purely jurisdictional considerations to an inquiry into the manner in which the actual regulation of innovative insurance products might be reviewed and improved if necessary. This shift is reflected in the Revised Report of the Joint Study Committee prepared in June, 1981 (the "Revised Report"), which states that the prupose of the project is ". . . to study and, if necessary, propose solutions to the problems that surround the marketing and sale of nontraditional life insurance and annuity contracts."

Unfortunately, much of the time of the Joint Study Committee to date has been spent deliberating over jurisdictional lines rather than assessing substantively the existing insurance regulatory scheme, identifying any shortcomings and formulating appropriate remedies. Indicative of this concern with jurisdiction is the continuing consideration by the Joint Study Committee of amending the Uniform Securities Act to allocate as between state regulatory bodies authority over certain insurance products.[2]

The Council believes that the importance which the Joint Study Committee has attached to amending the Uniform Securities Act as a means of enhancing the regulation of various insurance products is seriously misplaced. As discussed in greater detail below, we believe that the existing system of state insurance regulation is broad enough and flexible enough to adapt to any special concerns raised by innovative products. We further believe that there is no demonstrable need to amend the Uniform Securities Act to further this objective and submit that such an amendment would in fact result in an unwieldy, costly, and largely unnecessary system of state insurance regulation.

Background

Before addressing the specific reasons why we believe an amendment ot the Uniform Securities Act would be inappropriate, we believe it would be helpful to discuss briefly the regulatory environment in which insurance and annuity products presently exist.

Since the latter half of the 19th Century, the primary responsibility for the regulation of life insurance companies and their products has been vested with the insurance departments of the various states. State insurance regulation evolved as a means of assuring that a company's products are not such as to endanger its solvency and that the company's assets are adequate to meet its reserve liabilities. While financial solvency is still an important focus in life insurance regulation, the insurance regulatory system has expanded into a comprehensive framework touching all facets of the business, from its products to its distribution networks.

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1 NASAA Press Release, undated.

2 See NASAA/NAIC Joint Insurance Products Regulatory Study Committee Position Paper drafted in Phoenix, Arizona, February 27, 1981 (the "Phoenix Position Paper").

In addition to the states, the Securities and Exchange Commission ("SEC") plays a role in the regulation of certain aspects of the insurance business, to wit, the offering and sale of variable annuities and variable life insurance. The industry's experience with the regulation of variable contracts bears repeating in some detail, not only because it establishes a precedent for the current issue of insurance product regulation, but also because it reflects a logical and practical basis upon which to allocate state regulatory authority.

Beginning in the early 1950's, life insurance companies began marketing variable annuity contracts in an effort to provide an alternative to fixed dollar annuities. Fixed annuities were perceived as inadequate to provide life income after retirement because of their inability to reflect inflationary declines in the pruchasing power of the dollar. As the popularity of this form of contract increased, the SEC asserted, and the Supreme Court ultimately agreed, that variable annuity contracts were securities within the meaning of Section 3(a)(8) the Securities Act of 1933.[3] Subsequently, by administrative action, the SEC was also successful in asserting jurisdiction over variable life insurance contracts.[4]

The Supreme Court's conclusion that, for federal securities law purposes, variable annuities are securities gave rise to a jurisdictional debate between state securities regulators and state insurance regulators, with each group insisting that it had a regulatory role to play. As early as 1955, the NAIC Subcommittee on Variable Annuities reported that, while variable annuity contracts would likely necessitate individualized regulations and standards to ensure the protection of the public, their issuance and sale should nevertheless come under the jurisdiction of state insurance departments.[5]

Following the adoption of the Uniform Securities Act in 1956 in which variable annuities were defined as securities[6] and again following the Supreme Court's decision in VALIC, the Subcommittee on Variable Annuities advised the NAIC to alert all insurance commissioners to the possibility of dual state regulation of variable annuities.[7]

The clear consensus of the NAIC at that time was that it would not be desirable to involve state securities administrators in the regulation of variable annuities. The Subcommittee on Variable Annuities urged the NAIC to adopt uniform regulations applicable to variable annuity contracts and advised the NAIC that it would be necessary to modify the securities laws of many states to order to ". . . avoid the complexities of securities regulation of variable annuity insurance contracts."[8] By the late 1960's, most states had enacted various forms of legislation excluding[9] or exempting[10] variable annuities from their securities laws and vesting the sole authority to regulate these products in the state insurance commissioner.[11]

This movement toward exclusive insurance department regulation of variable annuities was accomplished over the objections of the NASAA (then known as the National Association of Securities Administrators). That organization suggested that variable annuity contracts were akin to "stock investment contracts" that were being sold under the guise of insurance products, a practice that was viewed as being detrimental to consumers in the absence of appropriate regulation under state securities laws.[12] During this period the NAIC proceeded with the development and adoption of a Model Variable Contract Law, which was subsequently amended to encompass variable life insurance as well. This model law established a comprehensive pattern of variable contract regulation and at the same time vested the sole authority to regulate these products in the department of insurance. Although the NASAA continued for some time to press for jurisdiction over these products, the sufficiency of the revamped system of insurance regulation and the lack of abuses left that group arguing jurisdiction for little more than jurisdiction's sake, and their objections ultimately ceased.

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3 SEC v. Variable Annuity Life Insurance Co., 359 U.S. 65 (1959); SEC v. United Benefit Life Insurance Company, 387 U.S. 202 (1967).

4 Securities Act Release No. 5360 (January 31, 1973).

5 1 NAIC Proceeding 164-165 (1956).

6 2 NAIC Proceedings 363 (1958). The definition of "security" contained in Section 401(e) of the Uniform Securities Act does, however, provide optional language by which variable annuities can be expected from that definition and thus removed from all provisions of the Act.

7 2 NAIC Proceedings 524 (1959).

8 1 NAIC Proceedings 221 (1968).

9 E.g., N.Y. Gen. Bus. Law §359-ff5(f).

10 E.g., Ill. Rev. Stat. Ch. 121 1/2, §137.3M.

11 E.g., Ill. Rev. Stat. Ch. 73, §857.24.

12 1959 NASAA Proceedings 56.

If the more innovative products now in the marketplace are perceived as giving rise to gaps in the current insurance regulatory system, those gaps should be closed by changes to the insurance laws and regulations just as they were in the case of variable contracts. This is certainly a more logical and efficient course of action than invoking a duplicative and largely inapplicable system of state securities regulation. The last decade of insurance department regulation of variable contracts bears out the correctness of such a decision.[13]

Innovative Products and Accompanying Concerns

Besides variable annuities and variable life insurance, the Joint Study Committee has identified universal life insurance, adjustable and indeterminate premium life insurance and deferred annuity contracts as insurance products that may have securities characteristics. Because of these perceived characteristics -- or for completely unrelated reasons – it has been suggested that these products present problems in the areas of marketing and sales.[14]

A fundamental problem that has faced the industry in addressing these concerns is that they have never been enunciated or explained in any detail by the Joint Study Committee. The Council urges the Joint Study Committee to direct its attention at this time to a thorough analysis of the existing insurance laws that impact upon the innovative products in question and pinpoint with specificity any gaps that are perceived in the regulatory system. This analytical process is a prerequisite to the solicitation and consideration of solution-oriented suggestions. Drawing on its own resources, the Council would, of course, be pleased to assist this effort.

As the Joint Study Committee assesses innovative insurance products and the interplay of the insurance regulatory sytem, we urge that it keep in mind that these products are contracts of insurance and not securities. There have been no judicial or administrative conclusions to the effect that state securities laws have any applicability to such products.[15] This is not to say, however, that the NASAA members of the Joint Study Committee do not have an important role to play in the process of assessing the adequacy of existing insurance regulation. Certainly their expertise and perspective are invaluable in this regard.

Perhaps too much importance has been attributed to repeated statements that many innovative insurance products have "securities characteristics." This presumably is a reference to the savings or investment features associated with the products, and seems to carry with it the inference that the products should consequently be construed as securities. As every commissioner is aware, virtually all life insurance and annuity products contain some element of investment or savings. The fact that the savings features of today's contracts have begun to reflect in a more prominent fashion the investment returns currently available on assets purchased with premiums and annuity considerations does not in itself cause those contracts to become securities.

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13 We know of nothing suggesting that the present system of regulating variable annuities and variable life insurance has proved inadequate. In fact, it is arguable that these products are over-regulated, since their issuance and sale is concurrently regulated by the SEC. In the absence of any abuses, we question the need to impose yet a third layer of regulation on these products as was recommended in the Phoenix Position Paper.

14 Revised Report, p.3.

15 The SEC has issued a policy statement in which it suggests that so-called "guaranteed investment contracts" may give rise to concerns under the federal securities laws. Securities Release No. 6051 (April 5, 1979). The SEC makes clear, however, that this statement is merely intended to offer interpretative guidance to assist those involved in the issuance and sale of such contracts in assessing their status under the federal securities laws. In the approximately two and a half years that the statement has been outstanding, only two life insurance companies have elected to register their fixed annuity contracts with the SEC. In both instances, the companies stated in their registration statements that, despite registration, they were not conceding that the contracts involved were securities within the meaning of the federal securities laws.

In responding to the SEC's inquiry into the status under the federal securities laws of "guaranteed investment contracts"[16] the Council pointed out that such contracts differed in only minor respects from "traditional" participating annuity contracts that have long been on the market, and retained the essential characteristics that cause them to be contracts of insurance.[17] The same traditional insurance guarantees accompany these contracts, and there is no shifitng of traditional insurance risks to the purchaser.[18] Similarly, life insurance contracts such as universal life and indeterminate premium and adjustable life are all forms of life insurance possessing the same risk-shifting attributes as their more traditional predecessors. They merely afford purchasers greater flexibility in designing their contracts so as to meet their individual needs.

Each of the insurance and annuity contracts which the Joint Study Committee is considering is subject to the existing system of state regulation. They will remain subject to that system regardless of whether or not they are subject to that system regardless of whether or not they are subject to state or federal securities regulation. Since it is difficult to question the desirability of having but one effective layer of regulation, the real question becomes whether the existing system of insurance regulation is sound enough and flexible enough to accomodate the innovative products now appearing in the marketplace. We most strongly believe that it is, and we urge the Joint Study Committee to focus its attention on improving the existing system rather than amending the Uniform Securities Act.

The balance of the Council's statement supports this conclusion, first by reviewing the breadth of existing state insurance regulation and its ability to deal with innovative products and second by setting forth our views on the difficulties and drawbacks of attempting to improve insurance regulation by amending the Uniform Securities Act.

The Adequacy of the Insurance Regulatory Structure

As noted above, the Council does not believe that amending the Uniform Securities Act will enhance the efficiency or operation of the regulatory environment within which innovative insurance product are developed and sold. Rather, we believe that the least burdensome and most productive solution to better regulation of such products is to evaluate the change as necessary existing insurance laws and regulations, and we urge that the Joint Study Committee devote its energies toward this end.

The following discussion details the existing insurance regulatory structure and points out those areas which are presently undergoing review. This discussion unequivocally demonstrates the thorough and dynamic nature of the current system. A proven and effective framework of consumer protection exists which must, by necessity, be the starting point in the examination of regulating newly developed insurance products. Particular attention has been focused on disclosure, merit regulation and agent licensing to demonstrate the extensive scope of insurance regulation existing in these areas.

The Council does not advocate that the present structure is immutable. To the contrary, the life insurance industry has historically supported and assisted the ongoing review of insurance regulation as changing conditions demand. Nonetheless, the enormous value of today's form of regulation cannot be cast aside; modifications and improvements within this system should be developed as established needs arise.

A. The Present System Comprehensively Regulates Disclosure

The NAIC Model Unfair Trade Practices Act provides the foundation of life insurance disclosure regulation.[19] This Model Act, which has been adopted in some form in virtually all jurisdictions,[20] defines those activities which are deemed to be unfair acts and practices, sets the scope of the application of the Act and provides penalties.

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16 Securities Act Release No. 5838 (June 22, 1977).

17 Letter from Paul J. Mason to George A. Fitzsimmons, October 6, 1977.

18 Id.

19 For ease of reference, discussions of statutory and regulatory requirements are couched in terms of NAIC Model Acts and Model Regulations. These Models have been adopted in varying degrees throughout the country. Where an NAIC Model has not been adopted, comparable requirements have frequently been established in that jurisdiction.

20 See Appendix A, attached.

A broad range of activity is encompassed by the act. Among disclosure related acts which are prohibited are:

1. Making, issuing or circulating illustrations, circulars, statements, sales presentations or comparisons which misrepresent the conditions or terms of the insurance policy

2. misrepresenting dividend or share of surplus data

3. misrepresenting financial condition

4. making or disseminating untrue, deceptive or misleading advertising

5. making false or fraudulent statements or representations relative to an application for insurance

The Model Unfair Trade Practices Act comprehensively regulates life insurers and their agents in the offering of a given product. Failure to comply with the provisions of the Act can result in monetary penalties and suspension or revocation of license. Hence, the Act addresses a wide range of disclosure activity and imposes significant sanctions for noncompliance.

The Model Unfair Trade Practices Act has also served as a foundation for the adoption of several model regulations which base their authority on that Act.

Unfair Claims Settlement Practices Model Regulation

This regulation prohibits the concealment of policy provisions pertinent to a claim by an agent. Further, claim notifications given to an agent are deemed to be notice to the insurer, thereby placing additional legal obligations upon the agent and the insurer.

NAIC Model Life Insurance Advertising Rules These rules, applicable to life insurance policies and annuities, set forth the standards by which advertisements are judged, and require "full and truthful disclosure." "Advertisement" is defined so as to include sales aids, sales training materials and materials prepared for use by sales personnel. The rules stipulate specific guidelines for the content and format of all advertisements, which guidelines are enforceable under the unfair trade practices act of the jurisdiction.

NAIC Model Solicitation Regulations Both the NAIC Life Insurance Solicitation Regulation and the Model Annuity and Deposit Fund Disclosure Regulation concern the ability of the buyer to select the most appropriate product for his needs, through required affirmative disclosure requirements and prohibited deceptive acts and practices. The first goal is addressed by the mandated provision of cost, value and contract data to the prospective purchaser. Agents are required to make disclosures as to their representation. Similar in purpose to the securities concept of "suitability," these regulations afford substantial protection to consumers by requiring that they be fully informed as to what they are purchasing and how their specific needs are being met.

B. The Present System Provides Significant Merit Regulation

The securities concept of merit regulation essentially requires a judgment as to the merit of a product after the product is fully developed and ready to market. The life insurance concept of merit regulation requires such a "point of sale" judgment and, in addition, sets standards within which the product must be developed. This distinction provides an added layer of protection for the consumer. Insurance regulation provides the mechanism to not only judge the product as it is ready for sale but also to influence the actual development of the product.

The vast majority of states require that all policy forms (including riders) be filed with the department of insurance. Such forms must contain specified statutory provisions and will not be approved by the commissioner of insurance unless conformity with required provisions exists. Further, the commissioner "may disapprove any such . . . policy . . . or endorsement . . . if in his judgment its issuance would be prejudicial to the interests of . . . policyholders or members or it contains provisions which are unjust, unfair or inequitable."[21]

While subject to judicial review, the commissioner's power to oversee the products to be sold by life insurers is extensive. The regulator is well-equipped to judge the merit of the product before it is issued to the consuming public.

The Model Unfiar Trade Practices Act addresses product construction as well as disclosure. The Act prohibits unfair discrimination in the development, pricing and sale of the insurance contract. Specifically, unfair discrimination between individuals of the same class of insureds is forbidden with respect to rates, dividends, benefits or other terms. Sex and marital status may not be used as a basis for refusing or limiting coverage. Failure to comply with these discrimination rules will subject the violating party to monetary penalties and license sanctions.

The NAIC Standard Valuation and Nonforfeiture Law and the NAIC Standard Individual Deferred Annuity Nonforfeiture Law set additional parameters within which policies and contracts must be developed. In order for a product to be approved for issuance, the valuation of the product and the benefits to which a forfeiting contractholder is entitled must meet set, statutory standards. These standards serve to markedly enhance the protection afforded to life insurance consumers by adding a degree of certainty to the application of the premium dollar spent. In December of 1980, the NAIC adopted an extensive set of amendments to the Standard Valuation and Nonforfeiture Law which increase the benefits provided by the law and allow insurance commissioners to deal more readily with newly developed products. These model amendments have already been adopted in 14 states.

The above narrative clearly demonstrates a viable and effective system of merit regulation of the life insurance industry. The current regulatory framework scrutinizes the merit of an insurance product at point of sale, establishes the boundaries within which the product must be developed, and is readily adaptable to changing environments. The combination of policy approval and policy content laws provides substantial consumer protection.

C. The Present System Provides Adequate Supervision and Control of Agents

The NAIC Model Agents and Brokers Licensing Act forms the basis of the supervision of life insurance agents. In order to secure a license to do business as such an agent, the applicants must meet certain standards and successfully complete an examination which tests their knowledge of the products which they intend to sell. All applicants must also be specifically appointed by an insurer which they propose to represent.

Although this act deals primarily with the conditions and procedure of agent examination and licensing, Section 8 addresses the circumstances under which a license may be denied, terminated or not renewed. Among the list of causes for such action are: violation of any law, rule or commissioner's order; misappropriation of funds; misrepresentation; commission of an unfair trade practice; or fraud and the use of fraudulent, coercive or dishonest practices. Should any agent or applicant be found to have committed such an act, he is subject to not only licensure sanctions but also a civil fine.

Common Law Private Right of Action Against Agent: In addition to the statutory controls upon agents and their principals, a large body of case law circumscribes agent activity. A private right of action for various acts and omissions of agents is clearly available, thereby affording an additional enforcement mechanism.

Knox v. Anderson, 297 F2d 702 (CA-9 Hawaii 1961, cert. denied 270 U.S. 915 (1962) is freguently cited as the landmark case in the field of agent liability. The action brought in Knox was principally founded in the tort of deceit due to the agent's grossly improper solicitation and sale of an unsuitable life insurance product to the plaintiff. The

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21 McKinney's Consol. Laws of New York, Annotated, Supp, Insurance Law § 154. The New York statute is representative of legislative grants of authority in other states. For a general discussion of Approval of Policy Forms, see 19 Appleman, Insurance Law and Practice § 10424.

court clearly recognized the availability of the tort action and the legal duty of suitability particularly in those instances where the agent holds himself out as an insurance "advisor." As well, a punitive damages award against the agent was upheld on appeal.

Perhaps the most succinct statement of an agent's tort liability may be found in Talbot v. Country Life Company, 8 Ill. App. 3d 1062, 291 N.E. 3d 830 (1973). In applying a general rule of tort law to insurance agents, the court held that " . . . one who enters upon an affirmative undertaking to perform a service for another, is required to exercise reasonable care in performing it, to avoid injury to the beneficiary of the undertaking." The cases imposing tort liability upon insurance agents are legion, with a virtually endless variety of factual circumstances.[22]

Agents are also exposed to contract liability in the sale of insurance products. For example, if an agent promises to secure coverage and then breaches that promise, resulting in damages to the plaintiff, the courts will enforce the customer's right of recovery. (See for example, Shea v. Jackson, (1968, D.C. App., 245 A. 3d 120). The concept of contract liability is succinctly set forth in Oney v. Barnes, 5 Ariz. App. 460, 428 P2d 124 (1967):

> "Any agent may unconditionally contract to provide insurance, and, if he fails to do so, the agent may be liable for the resulting loss from his breach of contract, or, the broker or agent may make himself liable under a contract requiring the agent to act in good faith and with reasonable diligence to secure insurance for his principal." (Citations omitted).

Common Law Private Right of Action Against Insurer: The insurance consumer may not only proceed against the agent, but also against the insurer under the theory of respondeat superior. In the event of agent negligence, the plaintiff may well look to the insurer for relief. As the court found in Boyle v. Colonial Life Insurance Company of America, 525, S.W. 2d 811 (Mo. 1975):

> "In the absence of fraud on the part of the agent and the insured, the company was bound by his acts, contracts and representations which are within his real or apparent authority." [Emphasis supplied].

These laws clearly impose upon the prudent insurer a mandate to act selectively and carefully in the agent selection process. In addition, responsible insurers seeking to minimize this kind of exposure will develop training and compliance programs designed to educate and reeducate their marketing sources as to their legal obligations.

Punitive Damages: The prospect of punitive damages awards is ever-present. As in Knox v. Anderson, referred to above, the plaintiff was awarded punitive damages in an action against the agent. This means of redress has been, and continues to be, recognized by courts, particularly as a deterrent mechanism.

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22 Cases annotated at 64 ALR 3d 398 and 72 ALR 3d 735.

For more in-depth analyses of cases in this area see Address by Bert M. Thompson, A.B.A. Section of Tort and Insurance Practice Committee on Life, Health, Public Regulation and Employee Benefits, January 9, 1981. See also Papers A.B.A. Section of Tort and Insurance Practice Committee on Life, Health, Public Regulation and Employee Benefits, January 9, 1981: "The Exposure of Life Insurance Agents to Liability for Their Acts and Omissions," H. James Douds; "Trial Tactics in Defending Life Insurers," Mark F. Hughes, Jr.; and, "Agent Professionalism Under ERISA," Peter B. Prestley.

The combination of statutory and common law constraints forms an impressive arsenal of consumer protection for the supervision and control of agents. A prospective agent must be appointed by a company and must deomonstrate knowledge of both the products to be sold and the law governing those products. Failure to comply with the insurance law (including the Unfiar Trade Practices Act) can result in civil fines and loss of license. Additionally, agents who misrepresent the products they sell or who fail to deliver on their promises take on serious legal exposure to their clients and customers.

D. The Present System Provides Additional Consumer Protection

In addition to the regulatory framework discussed above, the existing body of insurance law provides several consumer protections that go beyond protections available to securities purchasers. Paramount among these protections is the financial oversight of life insurance companies. Insurers doing business in a given jurisdiction are required to file annual statements setting forth data mandated by the commissioner and designed to elicit a true picture of the condition of that insurer. Statutory restrictions on investments, reserves, and deposits serve to enhance solvency. In the event the commissioner deems the financial health of an insurer to be impared, the regulator may take steps to protect the public interest by means of conservation, rehabilitation or liquidation. This oversight function is fulfilled through the statutory power to conduct examinations of the affairs of companies at prescribed statutory intervals and at such other times as the commissioner may deem necessary.

Insurance departments also examine the market conduct of the companies they regulate. The Unfair Trade Practices Act requires that insurers maintain "a complete record of all complaints which [they have] received since the date of [their] last examination." The analysis of these records forms an integral element to a market conduct examination. In fact, the NAIC has adopted a Model Regulation for Complaint Records to be Maintained Pursuant to the NAIC Unfair Trade Practices Act. This Model Regulation sets forth the specified content and format of the compaint records to be maintained by the insurance company.

In additon to monitoring complaint activity, insurance departments offer a forum for the making of consumer complaints. The department will take the role of arbiter/advocate in the resolution of disputes between an aggrieved insured and the insurance company. This process has proven to be an effective, timely mechanism available to consumers at no cost.

By overseeing financial condition and market conduct, the insurance regulator is able to provide a significant level of consumer protection. Thus, not only does the insurance department regulate disclosure, merit and agents, it also regulates the financial health and day-to-day dealings of the insurer.

E. The Present System Is Dynamic and Subject to Ongoing Regulatory Reform

The above framework constitutes an impressive framework for affording consumer protection; moreover, it is a dynamic process. Individual commissioners of insurance, legislators and the NAIC have been and continue to be active in seeking refinements and improvements to this regulatory system. The view of the NAIC regarding the strength of the insurance regulatory powers of its membership was perhaps best expressed in its 1978 Statement submitted to the Securities and Exchange Commission in response to a proposed rulemaking (Proposed Rule 154). In this statement the NAIC vigorously advocated the viability of insurance department supervision of life insurance companies. Due to the applicability of those remarks to the activity of the committee, we have attached the pertinent portion of the Statement as Appendix B.

As evidenced by its 1978 work, the NAIC continues to assess the regulatory base upon which its membership functions. During its June, 1981 meeting in Detroit, the NAIC revised its committee structure and assigned priorities. Specific tasks to be addressed include:

1. Development of recommendations on the model cost disclosure and solicitation regulation (assigned to the Task Force on Life Insurance Cost Disclosure of the Life Insurance Committee)

2. Review of dividend practices, lapsation and manipulation (assigned to the Task Force on Manipulation, Lapsation, Dividend Disclosure of the Life Insurance Committee)

3. Review of market conduct surveillance and consumer services systems (assigned to the Task Force on Market Conduct and Consumer Affairs Subcommittee)

All of these efforts are as relevant to new insurance products as they are to existing products and are fully capable of dealing with special investment features in these products.

Amending the Uniform Securities Act

The foregoing discussion demonstrates the comprehensiveness of the present system of state insurance regulstion and its ability to accomodate innovative products. These same characteristics bespeak the impracticality of amending the Uniform Securities Act. In addition, we believe that there are other considerations which evidence the inadvisability of such legislation.

One of the more significant conclusions drawn to date by the NAIC members of the Joint Study Committee is that "... the exclusive jurisdiction for all contracts issued by insurance companies should remain with the commissioner or director of insurance."[23] The Council is of the view that amending the Uniform Securities Act, whether in the form of a blanket exception for all "insurance products" from state securities laws or in the form of a bifurcated regulatory approach as recommended in the Phoenix Position Paper, would not be an effective means of preserving this jurisdictional exclusivity and would, at least in the case of the Phoenix approach, be antithetical to that objective. Both these approaches to amending the Uniform Securities Act are discussed below.

The Phoenix Approach

The underlying concept of the recommendation set forth in the Phoenix Position Paper is to amend the Uniform Securities Act to define and label as "securities" certain insurance products which purportedly differ from the mold of traditional insurance and annuity contracts because they have "securities characteristics." These "securities" would be exempt from the registration requirements of state securities laws provided they satisfy certain regulatory standards developed and approved jointly by the NASAA and the NAIC. Those products not satisfying such standards would be required to be registered as securities. Both exempt and registrable products would be subject to state securities antifraud provisions, and the insurance agents selling those products would have to secure a state securities license in addition to their insurance license.

This approach remains fundamentally objectionable in that it is diametrically opposed to the NAIC's stated objective of retaining the exclusive jurisdiction over insurance contracts within the state insurance department. It would require a determination of whether each product issued by a life insurance company fits within the definition of "security." This determination would be made by the state securities administrator, acting under the authority of the state securities law. There would be no more basis for a state insurance commissioner to have the authority to interpret these securities laws than there would be for a state securities administrator to be responsible for the administration of certain insurance statutes. Such an allocation of regulatory authority would severely erode the role of the insurance department in the regulation of insurance products.

Equally objectionable is the fact that attempting to delineate between insurance products and securities by means of any statutory definition can only spawn inconsistency and, ultimately, regulatory chaos. Every life insurance company would have 50 states securities departments deciding independently whether its various products are securities, with no assurance that the same product would not be classified as an insurance product in one state and a security in another. We believe the NAIC clearly recognized this shortcoming when it stated in its revised report that:

> Any attempt to decide which set of current regulatory protections should apply based on a bright line product definition is unlikely to succeed. *** It is therefore inappropriate to attempt to define exactly which contracts are securities and which are insurance.

This same conclusion was reached by the Council and later the SEC in the context of deferred annuity contracts.[24]

The Phoenix approach would also involve a system of dual state regulation that would in many ways be duplicative in its treatment of the terms and provisions of life insurance products, the licensing and supervision of agents, and the advertising and sales practices employed in marketing those products.

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23 Revised Report, p.3.

24 Letter from Paul J. Mason to George A. Fitzsimmons, July 17, 1978; Securities Act Release No. 6050 (April 5, 1979) withdrawing proposed Rule 154.

Finally, such an approach would seriously undermine the exempt status of many insurance products under the federal securities laws. Section 3 (a)(8) of the Securities Act of 1933, the basic exemptive provision applicable to insurance and annuity products, is grounded on the premise that state insurance authorities adequately regulate these products, thereby obviating the need for additional federal regulation. To have the NAIC place its imprimatur on a definition -- however worded -- categorizing certain insurance products as securities would be tantamount to inviting, if not paving the way, for the SEC to assert jurisdiction over those same products.

Blanket Definitional Exception

There has also been some thought given to an amendment to the Uniform Securities Act that would exclude from the definition of "security" all "insurance products" or all "contracts of insurance" issued by life insurance companies. At first blush, this appears to be an effective way to ensure that state insurance regulators will retain sole jurisdiction. However, while such an amendment might serve to deter some jurisdictional quarrels, it would not stand as a legal bar to an assertion that a contract issued by an insurer is in fact a security and subject to state securities laws. As with the Phoenix approach, this amendment would still invite securities administrators to classify certain products as "securities" outside the scope of "insurance" and thus not within the exclusionary language. Such an amendment would leave the insurance industry in the same uncertain environment that now exists under Section 3(a) (8) of the Securities Act of 1933. Prior to VALIC, Section 3(a) (8) appeared to exempt all annuity contracts. Nevertheless, the SEC argued and the Supreme Court held that a variable annuity contract was a security and consenquently not an annuity contract within the meaning of that section. A similar result was later reached with respect to variable life.

In summary, the entire exercise of drafting an amendment to the Uniform Securities Act. Having it approved by the Conference of Commissioners on Uniform State Laws and then adopting the amended language in the various states is both purposeless and detrimental to effective insurance regulation. Such legislation would not ensure the exclusive jurisdiction of the insurance department over insurance products any more than under the present state of the law. Further, if the legislation were to reflect the rationale of the Phoenix Position Paper, it would foster a completely untenable regulatory system.

Conclusion

We believe that the existing framework of state insurance regulation is sound and flexible enough to accomodate the needs of evolving insurance products. Consequently, there is no need to amend the Uniform Securities Act and subject those products to an additional layer of state regulation.

If the real objective of the Joint Study Committee is to strengthen as appropriate state regulation of innovative insurance products rather than deliberate endlessly over ways to allocate regulatory authority, it should initiate an earnest evaluation of the existing system of state insurance regulation and the adequacy of the system's application to such products. The diverse regulatory background and perspective of the Joint Study Committee make it well suited to that task.

The Council, of course, stands ready to assist the Joint Study Committee in whatever way possible as this project continues.