ORAL ARGUMENT SCHEDULED FOR FRIDAY, MAY 8, 2009

No. 09-1021 (consolidated with No. 09-1056)

UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT

AMERICAN EQUITY INVESTMENT LIFE INSURANCE COMPANY, et al.,
Petitioners,

v.

SECURITIES AND EXCHANGE COMMISSION,
Respondent.

On Petitions for Review of an Order of the
Securities and Exchange Commission

FINAL BRIEF OF THE SECURITIES AND EXCHANGE COMMISSION, RESPONDENT

DAVID M. BECKER
General Counsel

MARK D. CAHN
Deputy General Counsel

JACOB H. STILLMAN
Solicitor

MICHAEL A. CONLEY
Deputy Solicitor

DOMINICK V. FREDA
Senior Counsel

WILLIAM K. SHIREY
Senior Counsel

Securities and Exchange Commission
100 F St., NE
Washington, D.C. 20549-8010
(202) 551-5043 (Shirey)

CERTIFICATE AS TO PARTIES, RULINGS AND RELATED CASES

Parties and Amici. Parties and *amici* appearing in this Court are listed in the opening brief of petitioners American Equity Investment Life Insurance Company, et al. and in the opening brief of petitioner National Association of Insurance Commissioners, with the exception of the following *amici*: Phillip Roy Financial Services LLC and Phillip R. Wasserman; Allianz Life Insurance Company of North America; AARP; North American Securities Administrators Association, Inc.; and MetLife, Inc. There are no intervenors.

Rulings Under Review. The official citation to the final rule of the Securities and Exchange Commission under review is *Indexed Annuity and Certain Other Insurance Contracts,* Release Nos. 33-8996, 34-59221 (Jan. 8, 2009), published at 74 FR 3138 (Jan. 16, 2009), codified at 17 C.F.R. § 230.151A.

Related Cases. The consolidated cases on review have not previously been before this Court and there are no related cases.

TABLE OF CONTENTS

Page

CERTIFICATE AS TO PARTIES, RULINGS AND RELATED CASES ii

TABLE OF CONTENTS iii

TABLE OF AUTHORITIES vii

CITATION CONVENTIONS xiii

COUNTERSTATEMENT OF JURISDICTION AND STANDING 1

COUNTERSTATEMENT OF ISSUES 1

STATUTES AND REGULATIONS 2

COUNTERSTATEMENT OF CASE 2

A. Nature of the Case 2

B Indexed Annuities 6

1. Index-linked return 6

2. Surrender charges 8

3. Guaranteed minimum value 8

4. Insurance company risk management 10

C. Courts and the Commission Have Repeatedly Considered Whether New Forms of Annuities Are "Annuity Contracts" That Congress Intended to Exempt in Securities Act Section 3(a)(8). 11

1. Section 3(a)(8): Congress exempts traditional fixed annuities 11

2. *SEC v. VALIC*: the Supreme Court holds that variable "annuities" are not "annuity contracts" under Section 3(a)(8) 13

3. *SEC v. United Benefit*: the Supreme Court holds that a hybrid "annuity" product—partly fixed and partly variable —is not an "annuity contract" under Section 3(a)(8). 15

4. Rule 151: the Commission responds to new hybrid products by promulgating Rule 151, creating a safe harbor under Section 3(a)(8). 17

5. 1997 Concept Release: the Commission considers the latest hybrid annuity product—the indexed annuity— shortly after its introduction. 19

D. Rule 151A: The Commission Resolves the Uncertainty About the Regulatory Status of Indexed Annuities. 20

1. Provisions of Rule 151A 22

2. The Commission's reasoning underlying the adoption of Rule 151A 23

SUMMARY OF ARGUMENT 27

STANDARD OF REVIEW 29

ARGUMENT 30

I. RULE 151A SHOULD BE UPHELD BECAUSE IT IS BASED ON A REASONABLE CONSTRUCTION OF AMBIGUOUS LANGUAGE IN SECTION 3(a)(8). 30

A. *Chevron* Controls the Court's Review of Rule 151A. 30

B. Rule 151A Satisfies the First Step of the *Chevron* Analysis, Because Section 3(a)(8) Does Not Unambiguously Foreclose the Commission's Interpretation. 36

C. Rule 151A Satisfies the Second Step of the *Chevron* Analysis, Because It Reflects a Reasonable Interpretation of Section 3(a)(8) 43

1. The Commission's interpretation reflects a reasonable view of the investment risk borne by the purchasers of the contracts described by the Rule 44

2. The Commission reasonably considered the allocation of risk between the insurer and the contract purchaser in contracts described by Rule 151A 54

3. The Commission reasonably considered the marketing of the contracts described by Rule 151A 55

4. Rule 151A is consistent with Rule 151. 57

5. The remaining challenges to the reasonableness of the Commission's interpretation of Section 3(a)(8) are meritless 61

a. Rule 151A does not intrude on the states' regulation of contracts described by the Rule. 61

b. Rule 151A is reasonably limited to contracts that create a contractual obligation to pay an index-linked return 62

II. THE ARGUMENTS BASED ON ALLEGED DEFECTS IN THE COMMISSION'S ANALYSIS OF THE RULE'S IMPACT ON EFFICIENCY, COMPETITION AND CAPITAL FORMATION ARE MERITLESS AND, IN ANY EVENT, IRRELEVANT AS A MATTER OF LAW. 63

A. The Commission Considered and Properly Rejected Petitioners' Contentions Regarding the Rule's Impact on Efficiency, Competition, and Capital Formation. 64

B. In any Event, the Commission Was Not Required by the Statute To Conduct the Analysis of Efficiency, Competition, and Capital Formation 67

III. THE ARGUMENTS RAISED ONLY BY *AMICI* ARE PROCEDURALLY DEFECTIVE AND MERITLESS. 68

A. Wasserman's Argument That the Commission Did Not Adequately Address the Rule's Impact on Small Businesses Is Not Properly Before the Court and Is Meritless. 68

B. Allianz's Argument That Indexed Annuities Are Not Securities Under *Howey* Is Not Properly Before the Court and Is Meritless. 71

CONCLUSION 74

CERTIFICATE OF COMPLIANCE

REGULATORY ADDENDUM

CERTIFICATE OF SERVICE

TABLE OF AUTHORITIES

Cases **Page**

Akins v. FEC,
101 F.3d 731 (D.C. Cir. 1997),
vacated by 524 U.S. 11 (1998) 32

American Bankers Ass'n v. SEC ,
804 F.2d 739 (D.C. Cir. 1986) 35

*Associates in Adolescent Psychiatry v. Home Life Insurance Co.,
941 F.2d 561 (7th Cir. 1991) 38, 46, 48, 71, 72

Capital Network System, Inc. v. FCC,
28 F.3d 201 (D.C. Cir.1994) 57

Cargill Inc. v. Hardin,
452 F.2d 1154 (8th Cir. 1971). 10

Cement Kiln Recycling Coal. v. EPA,
255 F.3d 855 (D.C. Cir. 2001) 69

*Chevron U.S.A., Inc. v. Natural Resources Defense Council, Inc.,
467 U.S. 837 (1984) 30, 34, 36, 43

Consumer Electronics Ass'n v. FCC,
347 F.3d 291 (D.C. Cir. 2003) 30

Grainger v. State Security Life Ins.,
547 F.2d 303 (5th Cir. 1977) 56

Holding v. Cook,
521 F. Supp.2d 832 (C.D. Ill. 2007) 39

"*" denotes authorities principally relied upon.

Malone v. Addison Insurance Marketing, Inc.,
225 F. Supp.2d 743 (W.D. Ky. 2002) 39, 60

Mississippi Power & Light Co. v. Moore,
487 U.S. 354 (1988) 36

Motor & Equip. Mfrs. Ass'n v. Nichols,
142 F.3d 449 (D.C. Cir. 1998) 69

Narragansett Indian Tribe v. National Indian Gaming Comm'n,
158 F.3d 1335 (D.C. Cir. 1998) 68

National Association of Manufacturers v. Department of the Interior,
134 F.3d 1095 (D.C. Cir. 1998) 33

Nat'l Ass'n of Regulatory Utility Comm'rs v. FCC,
737 F.2d 1095 (D.C. Cir. 1984) 70

National Mining Ass'n v. Kempthorne,
512 F.3d 702 (D.C. Cir. 2008) 33

*NCTA v. Brand X,
545 U.S. 967 (2005) 31, 37, 43, 45, 48

New Jersey v. New York,
523 U.S. 767 (1998) 68

New York v. EPA,
443 F.3d 880 (D.C. Cir. 2006) 34

NOA v. Key Futures, Inc.,
638 F.2d 77 (9th Cir. 1980) 72

Northpoint Tech. v. FCC,
414 F.3d 61 (D.C. Cir. 2005) 30, 43

Ohio Power Co. v. FERC,
954 F.2d 779 (D.C. Cir. 1992) 65

Otto v. VALIC,
814 F.2d 1127 (7th Cir. 1986) 48

Peoria Union Stockyards Co. v. Pennsylvania Mutual Life Ins.,
698 F.2d 320 (7th Cir. 1983) 48

Rothwell v. Chubb Life Ins.,
1998 U.S. Dist. Lexis 22630 (D. N.H. Mar. 31, 1998) 46, 47, 49

SEC v. Belmont Reid & Co.,
794 F.2d 1388 (9th Cir. 1986) 72

SEC v. Edwards,
540 U.S. 389 (2004) 71

SEC v. Ralston Purina Co.,
346 U.S. 119 (1953) 11

*SEC v. United Benefit Life Ins. Co.,
387 U.S. 202 (1967) 15, 16, 23, 34-38, 40, 42, 56, 65

*SEC v. VALIC,
359 U.S. 65 (1959) 12-14, 16, 23, 24, 34-38, 40, 42, 62, 65, 71

SEC v. W.J. Howey Co.,
328 U.S. 202 (1946) 71

Sierra Club v. EPA,
292 F.3d 895 (D.C. Cir. 2002) 1

Star Wireless LLC v. FCC,
522 F.3d 469 (D.C. Cir. 2008) 63

United States v. Mead Corp.,
533 U.S. 218 (2001) 31

Valuevision Int'l, Inc. v. FCC,
149 F.3d 1204 (D.C. Cir. 1998) 69

Statutes

5 U.S.C. 601 68

5 U.S.C. 706 29

Securities Act Section 2(a)(10), 15 U.S.C. 77b(a)(10) 67

Securities Act Section 2(b), 15 U.S.C. 77b(b) 67

Securities Act Section 2(b), 15 U.S.C. 77b(b) 63-65, 67

Securities Act Section 3(a)(2), 15 U.S.C. 77c(a)(2) 67

Securities Act Section 3(a)(8), 15 U.S.C. 77c(a)(8) . . 2, 12, 13, 21, 23, 30, 31, 34, 35, 37-40, 42, 43, 55, 61

Securities Act Section 3(b), 15 U.S.C. 77c(b) 67

Securities Act Section 3(c), 15 U.S.C. 77c(c) 67

Securities Act Section 5, 15 U.S.C. 77e 11

Securities Act Section 7(a), 15 U.S.C. 77g(a) 67

Securities Act Section 7(b)(1), 15 U.S.C. 77g(b)(1) 67

Securities Act Section 7(b)(2), 15 U.S.C. 77g(b)(2) 67

Securities Act Section 8(a), 15 U.S.C. 77h(a) 67

Securities Act Section 8(c), 15 U.S.C. 77h(c) 67

Securities Act Section 8A(c)(1), 15 U.S.C. 77h-1(c)(1) 67

Securities Act Section 9(a), 15 U.S.C. 77i(a) 1, 29

Securities Act Section 10(a)(4), 15 U.S.C. 77j(a)(4) 67

Securities Act Section 10(b), 15 U.S.C. 77j(b) 67

Securities Act Section 10(c), 15 U.S.C. 77j(c) 67

Securities Act Section 10(d), 15 U.S.C. 77j(d) 67

Securities Act Section 19(a), 15 U.S.C. 77s(a) 1, 21, 30, 67

Securities Act Section 19(b)(1)(A)(v), 15 U.S.C. 77s(b)(1)(A)(v) 67

Securities Act Section 28, 15 U.S.C. 77z-3 67

Rules

Rule 151, 17 C.F.R. § 230.151 . . . . 17, 45, 57, 59

Rule 151A, 17 C.F.R. § 230.151A . . . 1, 21, 22, 36, 37, 39, 43, 44, 52, 57, 59, 61, 71

Other Authorities

DAVID R. ANDERSON, DENNIS J. SWEENEY, & THOMAS A. WILLIAMS, STATISTICS FOR BUSINESS AND ECONOMICS (1993) 53

FLORIDA DEP'T OF FINANCIAL SERVICES, EQUITY INDEXED ANNUITY INVESTOR ALERT, http://www.myfloridacfo.com/Consumers/Guides/Life/annuity_alert.htm) (last visited Apr. 6, 2009) 6, 8

G.W. FITCH, WHAT EVERYBODY WANTS TO KNOW ABOUT ANNUITIES (1934) . 13

INTERNATIONAL GLOSSARY OF BUSINESS VALUATION TERMS (2001), http://www.bvresources.com/FreeDownloads/IntGlossaryBVTerms2001.pdf (last visited Apr. 6, 2009). 49

JACK MARRION, INDEX ANNUITIES (2003) 9, 10

JOHN BLACK, OXFORD DICTIONARY OF ECONOMICS (2002) 52

NAFA, WHITE PAPER ON FIXED INDEXED INSURANCE PRODUCTS (Nov. 10, 2006) 10, 41, 72

NAIC STANDARD NONFORFEITURE LAW, § 4.B & 4.C 9, 26

Stephen E. Roth, The Securities Status of Life Insurance Products, 902 PLI/COMM 169 (Jan. 2008) 60

ZVI BODIE, ET AL., INVESTMENTS (2005) 52, 53

CITATION CONVENTIONS

Allianz:	*Amicus curiae* Allianz Life Insurance Co.
Allianz Br.#:	Page number in the brief of *amicus curiae* Allianz Life Insurance Co.
Allianz Mot.#:	Page number in the motion of Allianz Life Insurance Co. to participate as *amicus curiae*.
Industry Petitioners:	Petitioners American Equity Investment Life Insurance Company, BHC Marketing, Midland National Life Insurance Company, National Western Life Insurance Company, OM Financial Life Insurance Company, and Tucker Advisory Group, Inc.
IP Br.#:	Page number in the Industry Petitioners' brief.
JA#:	Page number in the Joint Appendix.
NAIC:	Petitioner National Association of Insurance Commissioners.
NAIC Add.#:	Page number in the addendum to the brief of petitioner NAIC.
NAIC Br.#:	Page number in the brief of petitioner NAIC.
NCOIL:	National Conference of Insurance Legislators.
RA#:	Page number in the Regulatory Addendum attached to the Commission's responding brief.
Wasserman:	*Amici* Phillip Roy Financial Services LLC and Phillip R. Wasserman.
Wasserman Br.#:	Page number in brief of *amici* Phillip R. Wasserman and Phillip Roy Financial Services LLC.

COUNTERSTATEMENT OF JURISDICTION AND STANDING

The Commission promulgated Rule 151A, 17 C.F.R. § 230.151A, on January 8, 2009, pursuant to its jurisdiction under Section 19(a) of the Securities Act, 15 U.S.C. 77s(a). Industry Petitioners filed a timely petition for review on January 16, 2009 (Case No. 09-1021). On February 10, 2009, NAIC and NCOIL filed a timely petition for review (Case No. 09-1056). This Court has jurisdiction pursuant to Section 9(a) of the Securities Act, 15 U.S.C. 77i(a). On February 13, 2009, the Court consolidated Case Nos. 09-1021 and 09-1056. On February 17, 2009, petitioner NCOIL moved to withdraw as a petitioner and participate as an *amicus*.

NAIC lacks standing. It has not identified any cognizable "injury in fact" that its members (state insurance regulators) or their constituents will suffer as a result of Rule 151A (which does not preempt any state law), and has not provided an "affidavit or other evidence" demonstrating a "substantial probability" of such an injury, as this Court requires. Sierra Club v. EPA, 292 F.3d 895, 899 (D.C. Cir. 2002) (citation omitted).

COUNTERSTATEMENT OF ISSUES

1. Whether Rule 151A is based on a permissible construction of the term "annuity contract" in Section 3(a)(8) of the Securities Act.

2. Whether the challenges to the Commission's analysis of the effects of Rule 151A on efficiency, competition, and capital formation are without merit *both* because the Commission's analysis was adequate *and* because the Securities Act does not require such an analysis when the Commission defines statutory terms under Section 19(a).

3. Whether arguments made only by *amici* are not properly before the Court because they address issues that were not raised by any party and, in any event, lack merit.

STATUTES AND REGULATIONS

Pertinent statutes and regulations are set forth in petitioners' briefs and in the regulatory addendum to this brief.

COUNTERSTATEMENT OF CASE

A. Nature of the Case

Rule 151A clarifies the status under the federal securities laws of indexed annuities. These products, like all annuities, are "investment contracts" covered by the securities laws unless they qualify for an exemption. Section 3(a)(8) of the Securities Act, 15 U.S.C. 77c(a)(8), provides an exemption from registration under the Act for an "annuity contract" or "optional annuity contract" (hereinafter "annuity contract"), but the Securities Act does not define either term. The

Supreme Court held a half-century ago that not all contracts labeled "annuities" are eligible for the Section 3(a)(8) exemption. Instead, the critical question is whether the contract presents investment risks that the Securities Act was enacted to address. If so, the contract is not an exempt "annuity contract." Rule 151A describes indexed annuities that not qualify for the Section 3(a)(8) exemption.

Rule 151A is limited to indexed annuities that are "more likely than not" to pay a return based on the uncertain future performance of a fluctuating index of securities such as the Standard & Poor's 500 Index. The Commission reasonably determined that these products expose purchasers to substantial investment risk. Such risk exists for the simple reason that purchasers cannot know in advance how much money they will make in light of the inherent unpredictability of the securities market.

Petitioners contend that the Rule rests on an unreasonable definition of investment risk.[1/] They claim that investment risk exists ***only*** where there is the potential to lose principal. In their view, so long as an investor is guaranteed not to lose what she pays for an indexed annuity (minus any charge for early withdrawal from the contract), there is no investment risk.

---

[1] All references to arguments by petitioners include similar arguments made by *amici* unless otherwise indicated.

That narrow definition of investment risk is not compelled by any case and is inconsistent with longstanding Commission statements and common usage. Courts have recognized that even where an annuity contract guarantees a return of principal, it may still pose investment risk warranting the protections of the securities laws. Similarly, in a rule promulgated nearly a quarter century ago, the Commission made clear that investment risk is not eliminated by guaranteeing the return of principal.

Moreover, as the Commission explained in this rulemaking, petitioners' position also contravenes the common understanding of investment risk. For example, an investment product that guarantees a return of the amount of money initially invested plus a fixed 10% profit after five years is commonly viewed as *less risky* than an investment product that also guarantees a return of the amount of money initially invested but promises a profit of somewhere in the range of 1% to 20% to be determined at the end of five years. Indeed, it is hard to imagine any reasonable investor concluding that the second product is completely free of investment risk simply because it guarantees that the worst case scenario is a return of what was initially invested plus a 1% profit. It is equally clear that, as the Commission found, an investor who chooses the second investment product over the first does so because she is willing to risk losing a higher *guaranteed*

profit (10% instead of 1%) in order to have a chance of making a higher *potential* profit (somewhere between 10% and 20%).

This is the very kind of investment risk that even petitioner NAIC acknowledges is a defining characteristic of the indexed annuities that are the subject of Rule 151A. The Buyer's Guide published as part of NAIC's Annuity Disclosure Model Regulation states that indexed annuities present a level of investment "risk" that falls between the two extremes of variable annuities (which are securities) and traditional fixed-rate annuities (which are not securities). NAIC Add.45 ("[A]m I somewhere in between and willing to take *some risks* with an equity-indexed annuity?"); see also JA297.

The Commission's (and NAIC's pre-litigation) view that purchasers of indexed annuities face investment risk makes sense. Such risk exists because someone who invests in an indexed annuity does not know *in advance* how much he or she will receive under the contract, which depends on the fluctuating performance of a securities index. It is this prospect of uncertain market-linked returns—which indexed annuities share with mutual funds, variable annuities, and other securities-linked investments—that led the Commission to conclude that purchasers of these products are entitled to the same protections that securities laws afford other securities purchasers. See RA152.

B. Indexed Annuities

An indexed annuity differs significantly from a traditional, or fixed, annuity, although both types are contracts, issued by a life insurance company, that generally provide for the accumulation of the purchaser's payments, followed by a payout of the accumulated value either as a lump sum (upon death or withdrawal) or as a series of payments (an "annuity"). RA158. In the case of an indexed annuity, during the accumulation period the insurer credits the purchaser with a return that is based on changes in a securities index, such as the Dow Jones Industrial Average, Nasdaq 100 Index, or Standard & Poor's 500 Index. RA158.

1. Index-linked return

The index-linked return is typically determined by a complex formula set by the insurer at the beginning of each crediting period—i.e., the period over which a return is calculated under a contract. But, the purchaser's actual return cannot be calculated until the end of each crediting period because the return depends on the performance of the index during the crediting period. RA159.[2/] The crediting

---

[2] Although the promise of market-based returns in these contracts may sound straightforward, in operation, indexed annuities are "extremely complex investment products." FLORIDA DEP'T OF FINANCIAL SERVICES, EQUITY INDEXED ANNUITY INVESTOR ALERT; FINRA, EQUITY INDEXED ANNUITIES—A COMPLEX CHOICE (updated Apr. 22, 2008) ("Because of the variety and complexity of the methods used to credit interest, investors will find it difficult to compare one [indexed annuity] to another.").

period is generally at least one year long and the return credited is locked in after each period. RA159.

The index-linked return credited can vary not only based on the performance of the index, but also based on the particular terms of the indexed annuity contract. RA159; see also JA306 (AMERICAN EQUITY LIFE INS., BONUS GOLD INDEX ANNUITY brochure (listing eight different indexed annuity products with different combinations of features)). These include the method of computing the index change[3] (RA159-60) and limitations on the proportion of index change credited as a result of a cap,[4] a participation rate,[5] and/or a spread.[6] RA160.

---

[3] Commonly used methods for computing the index change include the "point-to-point method"—which "compares the index level at two discrete points in time, such as the beginning and ending dates of the crediting period" (RA160-61)—and the "averaging method"—which calculates the difference in the index level from a starting date (either the contract date or a subsequent anniversary) to the daily or month-end average value over some subsequent period (JA451). See, e.g., JA314-15 (OLD MUTUAL LIFE INS., SAFETY INDEX® 10 brochure); see also generally JA450-53 (discussing various methods for calculating index change).

[4] A "cap" is a ceiling on the index-based returns that may be credited; for example, if the change in the index is 6%, and the contract has a 5% cap, 5% will be credited. RA160.

[5] A "participation rate" is the percentage of the index growth to be credited; for example, if the change in the index is 6% and the contract has a 75% participation rate, the gain credited would be 4.5% (75% of 6%). RA160.

[6] A "spread" is a deduction from the amount of gain in the index; if the change in the index is 6%, and the contract has a spread of 1%, the gain credited would be 5%. RA160.

2. Surrender charges

Surrender charges are commonly deducted from withdrawals in excess of 10% of the contract value made in the first 10 or more years of an indexed annuity. RA160; JA455-56. These charges "may have the effect of reducing or eliminating any index-based return credited to the purchaser up to the time of a withdrawal" (RA161), as well as resulting in a loss of principal. [7/] Typically, the maximum charges are imposed on surrenders made during the early years of the contract and decline gradually to 0% at the end of a specified surrender charge period, which may be in excess of 15 years. RA161.[8/]

3. Guaranteed minimum value

Indexed annuities provide a guaranteed minimum value. RA161-62, n.24; see also JA306; IP Br. 6. State laws generally require that the minimum guarantee be at least 87.5% of purchase payments, accumulated at an annual interest rate of 1 to 3 percent. RA162. This minimum guarantee serves as a floor on the amount paid upon withdrawal or as a death benefit, or the amount used as a basis for

---

[7] FLORIDA DEP'T OF FINANCIAL SERVICES, EQUITY INDEXED ANNUITY INVESTOR ALERT ("Investors needing to cancel an annuity to access funds prior to maturity of the contract may also lose principal through surrender charges.").

[8] See, e.g., JA306 (annual surrender charges for American Equity's "Bonus Gold" contract); JA326 (annual surrender charges for OM Financial Life's "Safety Index® 7" contract).

determining the amount of annuity payments. RA161-62. Assuming a guarantee of 87.5% of purchase payments, accumulated at 1% interest compounded annually, it would take approximately 13 years for a purchaser's guaranteed minimum value to be 100% of purchase payments. RA162.

Although Industry Petitioners state that "purchasers *receive* a minimum amount of interest (typically from 1 to 3 percent annually), *regardless of the performance of the relevant index*" (IP Br. 8),[9] this is inaccurate. As discussed above, the 1-to-3% interest "guarantee" is the annual adjustment to the floor established by the minimum guarantee—nothing more. See JACK MARRION, INDEX ANNUITIES, at 21 (2003). So, for example, assuming a 3% interest guarantee, "if the index annuity crediting formula produced returns of zero in year one, zero in year two, and ten percent in year three, the annuity contract wouldn't credit 3%, 3%, 10%; instead it would show 0%, 0%, 10%." Id. The investor receives the benefit of the guaranteed interest rate *only* if, on payout, the total index-linked value under the contract is *less than* the floor established by the minimum guaranteed value. See id. ("The minimum guarantee almost becomes irrelevant from a protection point of view after the calculated interest-linked gain exceeds it.").

---

[9] All emphasis in quotations in this brief has been added unless otherwise indicated.

4. Insurance company risk management

As a trade association representing indexed annuity issuers explains, insurance companies employ different methods to cover their "two types of risks" under the indexed contracts—i.e., "the guarantee of the floor and the guarantee of the excess [return] resulting from positive changes in the applicable index." NAFA, WHITE PAPER ON FIXED INDEXED INSURANCE PRODUCTS (Nov. 10, 2006), at 11. To cover the guaranteed return, insurers invest the bulk of the premiums in traditionally-safe, fixed-income securities. Id.

To cover the index-linked portion of the contract, insurance companies commonly enter into hedging contracts such as options and futures.[10] Id. (noting that insurers try "to structure the options and futures purchases so that their payoff or value will produce whatever interest rate" will be payable under the index-linked component of the indexed annuity). In addition to transferring their risk to third parties through hedging, insurers typically can annually adjust the indexed annuity's cap, participation rate, and/or spread in order to limit or control their future financial exposure. RA180-81. As the Commission explained, in

---

[10] Hedging is a risk management strategy used in limiting or offsetting probability of loss from fluctuations in the prices of commodities, currencies, or securities. In effect, hedging is a transfer of risk without buying insurance policies that essentially involves taking equal and opposite positions in two different markets. See Cargill Inc. v. Hardin, 452 F.2d 1154, 1158 (8th Cir. 1971).

combination, these various mechanisms let insurance companies effectively "reduce or eliminate their investment risks." RA180-81.

C. Courts and the Commission Have Repeatedly Considered Whether New Forms of Annuities Are "Annuity Contracts" That Congress Intended to Exempt in Securities Act Section 3(a)(8).

The rulemaking at issue in this case is the most recent in a series of judicial and Commission interpretations of the Section 3(a)(8) exemption that Congress enacted in 1933. Beginning in 1959, the Supreme Court, other federal courts, and the Commission have addressed whether various new forms of annuities developed and offered by life insurance companies are the sort of "annuity contract" that Congress intended to exempt from the protections of the securities laws.

1. Section 3(a)(8): Congress exempts traditional fixed annuities.

The Securities Act was designed "to protect investors by promoting full disclosure of information thought necessary to informed investment decisions." SEC v. Ralston Purina Co., 346 U.S. 119, 124-25 (1953). Section 5 of the Securities Act, 15 U.S.C. 77e, requires that the offer or sale of securities to the public be accompanied by the full and fair disclosure afforded by registration with the Commission and delivery of a statutory prospectus. In Section 3(a)(8), Congress exempted from this statutory scheme any "insurance policy" or "annuity

contract" issued by a corporation subject to the supervision of an insurance commissioner or similar state regulatory authority. [11] It is well established that the exemption is not available to all products labeled (or regulated by states as) "annuity contracts." See SEC v. VALIC, 359 U.S. 65, 69-73 (1959); see also RA163.

When the Securities Act was enacted in 1933, instruments "traditionally and customarily" offered as annuities—and therefore understood to be exempt under Section 3(a)(8)—were what today are called "fixed" or "traditional annuities." RA170 (citing VALIC, 359 U.S. at 69). Under a fixed annuity contract, in contrast to an indexed annuity, "the insurer assumes the investment risk by guaranteeing principal and interest for the life of the contract." RA8, n.3; see also, e.g., VALIC, 359 U.S. at 69 (fixed annuities "offer[] the annuitant specified and definite amounts beginning with a certain year of his or her life"); G.W. FITCH, WHAT EVERYBODY WANTS TO KNOW ABOUT ANNUITIES 9 (1934) ("An annuity is a fixed income received regularly for a term of years or for life. It is paid for in a single sum or in smaller payments made annually.").

---

[11] The Commission has previously stated its view that Congress intended any insurance contract falling within Section 3(a)(8) to be excluded from all provisions of the Securities Act notwithstanding the language of the Act indicating that Section 3(a)(8) is an exemption from the registration but not the antifraud provisions. RA163, n.27.

Because of this fixed guarantee of returns, the only risk a purchaser of a fixed annuity faces is the possible insolvency of the insurance company. VALIC, 359 U.S. at 77. Congress recognized that this risk could be met by state insurance law, which regulated the "adequacy of reserves to meet the company's obligations." Id.

2. ***SEC v. VALIC*: the Supreme Court holds that variable "annuities" are not "annuity contracts" under Section 3(a)(8).**

Beginning in 1952, insurance companies started offering a new financial product called a "variable annuity." VALIC, 359 U.S. at 69. These variable annuities differed from the fixed annuities that existed when Congress enacted the Section 3(a)(8) exemption, because "[t]he holder of a variable annuity [could not] look forward to a fixed monthly or yearly amount in his advancing years." Id. at 70. The holder got "*only* a pro rata share of a portfolio" of securities that the issuer set up and managed. Id.

In VALIC, the Supreme Court held that such variable annuities do not fall within the Section 3(a)(8) exemption. The Court made clear that "the meaning of 'insurance' or 'annuity' under [the Securities Act] is a federal question"—that is, it is not determined by state law. VALIC, 359 U.S. at 69. The Court explained that, by not guaranteeing any fixed investment, "the variable annuity places all of the

investment risks on the annuitant, none on the company," and thus does not fall within Section 3(a)(8)'s exemption. Id. at 71.

Justice Brennan, joined by Justice Stewart, wrote a concurrence further analyzing of why variable annuities are not exempt under Section 3(a)(8). See VALIC, 359 U.S. at 73-81. As the concurrence explained, when "a brand-new form of investment arrangement emerges which is labeled 'insurance' or 'annuity' by its promoters, the functional distinction that Congress set up in 1933 . . . must be examined to test whether the contract falls within the sort of investment form that Congress was then willing to leave exclusively to the State Insurance Commissioners." Id. at 76. That inquiry should involve "an analysis of the regulatory and protective purposes of the Federal Acts and of state insurance regulation as it then existed"—i.e., "the scope of state regulation in 1933." Id. at 76 n.5.

Examining those separate regulatory schemes, the concurrence explained that "[t]he emphasis [of the Securities Act] is on disclosure" necessary for an investor to "intelligently appraise the risks" of an investment. Id. at 77. By contrast, state insurance regulation in 1933 (when Section 3(a)(8) was enacted) focused primarily on ensuring "[s]olvency and the adequacy of reserves to meet the company's obligations . . . by the establishment of permissible categories of

investments and through official examination," rather than "depend[ing] on disclosure to the public." Id.

3. ***SEC v. United Benefit*: the Supreme Court holds that a hybrid "annuity" product—partly fixed and partly variable—is not an "annuity contract" under Section 3(a)(8).**

Less than a decade later, in SEC v. United Benefit Life Insurance, 387 U.S. 202 (1967), the Supreme Court held that a contract called a "Flexible Fund Annuity," an instrument "somewhat similar" to a variable annuity, was not exempt under Section 3(a)(8).

The Flexible Fund was a hybrid product, offering the purchaser the ability to obtain the "benefits of a professional investment program" (akin to a variable annuity) "while at the same time gaining the security of [a traditional] insurance annuity." Id. at 204. The Flexible Fund functioned like a variable annuity in that the net premiums were placed in an account separate from the insurance company's other funds for investment purposes, and the purchaser was entitled to his proportionate share of the total fund, including earnings thereon. Id. at 205. Unlike the variable annuity in VALIC, however, the issuer guaranteed that the purchaser would receive a percentage of his premiums back. Id. This minimum guarantee increased from 50% of net premiums in the first year to 100% after 10 years. Id.

The Court made explicit that whether new financial products such as variable annuities are exempt under Section 3(a)(8) does *not* turn on whether the states may have decided to regulate these new products as annuities under state insurance law. See United Benefit, 387 U.S. at 210 (expressly rejecting the position taken by the dissent in VALIC that, even though new forms of contract developed by insurers "may also have securities aspects, [such contracts should] be classed within the federal exemption of insurance, and not within the federal regulation of securities" (VALIC, 359 U.S. at 100 (Harlan, J., dissenting)).

Rather, the Court made clear that the critical inquiry for the Section 3(a)(8) exemption is whether the new product raises issues that the disclosure regime established by the Securities Act was enacted to address; that is, issues necessitating disclosure so that investors can accurately appraise their investment risk. United Benefit, 387 U.S. at 210 (citing VALIC, 359 U.S. at 75). Although there were aspects of the contract, such as the minimum guaranteed value, that operated like traditional insurance to shift risk to the issuer, the Court concluded that the substantial investment risk borne by the purchaser required application of the disclosure provisions of the Securities Act. See id. at 211.

4. Rule 151: the Commission responds to new hybrid products by promulgating Rule 151, creating a safe harbor under Section 3(a)(8).

In 1984, the Commission proposed a rule to establish a safe harbor under Section 3(a)(8) for a new hybrid financial instrument known generally as a "guaranteed investment contract." RA2-3. A guaranteed investment contract is an annuity under which the purchaser agrees to pay money to an insurer (either in a lump sum or in installments) and the insurer promises a return at a guaranteed rate for the life of the contract, and, in some contracts, the insurer may periodically pay a discretionary amount over and above the guaranteed return. RA8. The proposed rule was intended to provide "greater certainty" by providing that, under specified conditions, an annuity would qualify for the Section 3(a)(8) exemption notwithstanding the discretionary payment component of the contract. RA2-3.

In 1986, the Commission adopted Rule 151, 17 C.F.R. § 230.151, which sets forth a multi-prong test for determining whether the safe harbor applies. RA22-23. Rule 151 includes requirements that the contract must: (1) sufficiently guarantee principal and interest for the insurer to be "deemed to assume the investment risk" (RA22-23); and (2) "not [be] marketed primarily as an investment" (RA22). With respect to the first requirement, Rule 151 sets precise criteria that a contract must satisfy in order for the insurer to establish that it has

assumed "sufficient" investment risk to fall within the safe harbor. RA14. Among these are certain guarantees relating to purchase payments and rates of return on the payments (RA14-16), and the important requirement that the *rate* of any return in excess of the minimum guaranteed rate ("excess return") be set *in advance of each crediting period* (i.e., prospectively) and not be modified more than once per year (RA19).

In proposing Rule 151, the Commission had expressed the view that the safe harbor should not be available where an issuer calculates the rate of any excess return by reference to an index. RA9, n.19. The Commission was concerned that an issuer that "externalizes" its excess return rate by referring to an index would place too much investment risk on the purchaser. RA9, n.19; see also RA19. In the final rule, the Commission decided to permit "limited" reference to an index to set the rate: the index must be used to set a rate *before* each crediting period begins and the rate must remain in effect for at least one year. RA19. (Thus, contrary to Industry Petitioners' contention (at 19-20, 46-47), the safe harbor does not apply to contracts such as indexed annuities where the index-linked *rate* of return is determined only at the *end* of each crediting period by a *formula* established at the *beginning* of the crediting period.)

5. 1997 Concept Release: the Commission considers the latest hybrid annuity product—the indexed annuity—shortly after its introduction.

In 1997, the Commission requested public comment on the structure and marketing of indexed annuities in connection with its consideration of the status under the securities laws of indexed annuities and other indexed insurance products. RA30. As the Commission explained, indexed annuities had been introduced into the financial markets only in 1995, and there was "substantial uncertainty" as to whether these products were entitled to the Section 3(a)(8) exemption. RA32. The Commission further explained that this uncertainty was due in part to the fact that "indexed insurance products combine features of traditional insurance products (guaranteed minimum return) and traditional securities (return linked to equity markets)." RA32.

The concept release offered a number of reasons to question whether indexed annuities qualify for the Section 3(a)(8) exemption. RA40-50. Among these is the ability of issuers to hedge their obligations to pay the index-linked return, see supra p. 10, and the effect this may have on whether insurers "bear investment risk with respect to those obligations." RA43-44. Additionally, the Commission questioned whether an annuity with an index-based rate of return determined at the *end* of a crediting period, unlike in instruments covered by Rule

151, places too much risk on the purchasers to be exempt under Section 3(a)(8). RA45-47. Referring to its "expressed concern" when it promulgated Rule 151, the Commission explained that such retrospective determination of the excess rate shifts the risk of fluctuations in an index-linked rate to the contract owner, which is the reason the Commission decided "to limit the benefit of [the] Rule 151 [safe harbor] to situations where an index is used to fix a specific interest rate *in advance*." RA46.

Finally, the Commission expressed "concern[] that the nature of equity index insurance products may make it particularly difficult to market these products without primary emphasis on their investment aspects," thereby potentially making these contracts appear to purchasers more like investments than insurance. RA47.

D. Rule 151A: The Commission Resolves the Uncertainty About the Regulatory Status of Indexed Annuities.

Although the sales volumes of indexed annuities were relatively small in the initial years, by 2007, investments in indexed annuities totaled $123 billion, 58 companies were issuing indexed annuities, and there were a total of 322 indexed annuity contracts offered. RA155-56. Despite the dramatic increase in sales volume, the status of indexed annuities under the securities laws had remained "uncertain since their introduction" (RA155), with insurers, sellers, and purchasers

left without any clear answer as to whether these contracts qualified as "annuity contracts" under the Section 3(a)(8) exemption. RA153; RA156. Given the uncertainty surrounding the status of indexed annuities, life insurance companies typically had elected not to register such contracts with the Commission. RA162. Nor had these contracts been sold through registered broker-dealers, who are subject to a federal obligation to recommend to clients only financial products that are suitable for their clients' investing goals and needs. RA249-50; see also infra p. 27, note 15.

In light of the significant increase in indexed annuity sales and increase in claims of abusive practices in the sale of these products (RA157),[12/] the Commission acted to resolve the uncertainty regarding their regulatory status. In June 2008, the Commission proposed a rule, pursuant to the Commission's definitional authority under Section 19(a) of the Securities Act, to "prospectively define certain indexed annuities as not being 'annuity contracts' " under Section 3(a)(8), and, therefore, subject to the securities laws. RA151; see also RA298. After considering approximately 4,800 comments, the Commission issued the release adopting Rule 151A on January 8, 2009.[13/] RA154.

---

[12] See also RA66-68 & nn. 23-26 (citing among other sources: NASD, EQUITY-INDEXED ANNUITIES, NOTICE TO MEMBERS 05-50 (Aug. 2005)).

[13] One of the five Commissioners dissented.

1. Provisions of Rule 151A

Rule 151A provides in pertinent part that a contract that is regulated as an annuity under state insurance law is not a Section 3(a)(8) "annuity contract" if:

> (1) The contract specifies that amounts payable by the issuer under the contract are calculated *at or after the end* of one or more specified crediting periods, in whole or in part, by reference to the performance during the crediting period or periods of a security, including a group or index of securities; and
>
> (2) Amounts payable by the issuer under the contract are more likely than not to exceed the amounts guaranteed under the contract.

RA152.

The effective date of Rule 151A is January 12, 2011—two years after its adoption; it will apply to all contracts issued on or after that date. RA209-10. The Adopting Release noted several items that would be required to be disclosed in the prospectus, including "information about costs (such as surrender charges); the method of computing indexed return (e.g., applicable index, method for determining change in index, caps, participation rates, spreads); minimum guarantees, as well as guarantees, or lack thereof, with respect to the method for computing indexed return; and benefits (lump sum, as well as annuity and death benefits)." RA245-46. As the Commission explained, public availability of this information—which relates to the investment risk borne by the purchaser—"will

be helpful to investors in making informed decisions about purchasing indexed annuities." RA245.

2. The Commission's reasoning underlying the adoption of Rule 151A

Because "indexed annuities did not exist and were not contemplated by Congress when it enacted the [Section 3(a)(8)] exemption," the Commission engaged in a functional analysis to determine whether indexed annuity contracts, even though labeled annuities, are the sort of arrangement that Congress was willing to leave exclusively to the state insurance commissioners. RA169. In undertaking this analysis, the Commission looked to the "factors articulated by the U.S. Supreme Court in VALIC and United Benefit." RA169.

Investment Risk. The Commission began its consideration of risk by recognizing that a principal congressional concern underlying the Securities Act was ensuring that purchasers are afforded relevant disclosures when a financial product poses investment risk. RA169-173. Citing VALIC and United Benefit, the Commission explained that the basis for the "annuity contract" exemption was that the annuities offered when Section 3(a)(8) was enacted—fixed annuities—guaranteed a "specified and definite" return that "typically involved no investment risk to the purchaser" that implicated the protective purposes of the securities laws. RA170-71. The only investment risk remaining when an insurance

company offers a fixed guaranteed return—insolvency of the insurance company resulting in an inability to meet the fixed obligation—was therefore properly left to the states' insurance laws. RA170-71 (citing VALIC, 359 U.S. at 75); RA216-17; see also VALIC, 359 U.S. at 77 & n.8.

By contrast, the Commission explained that "[i]ndividuals who purchase indexed annuities are exposed to a significant investment risk—i.e., the volatility of the underlying securities index"—that the securities laws were enacted to address. RA151; see also RA171 ("By purchasing . . . [an] indexed annuity, the purchaser assumes the risk of an uncertain and fluctuating financial instrument, in exchange for participation in future securities-linked returns."). In reaching this conclusion, the Commission considered and rejected the contention of certain commenters that the purchaser of an indexed annuity does not assume investment risk because of the minimum guaranteed contract value. RA174-75; RA179-81. Although the Commission recognized that the guarantee of principal and a minimum rate of return "provide[s] some protection against the risk of loss," this guarantee "do[es] *not* eliminate" "a purchaser's exposure to investment risk under the contract." RA171 (emphasis in original); see also RA180-81.

Investment risk, the Commission explained, is present where investors are left to make their investment decisions based on an uncertain and fluctuating

future return (instead of, by contrast, a fixed, guaranteed return). RA177-79. This, the Commission determined, is the situation faced by a potential purchaser of an indexed annuity defined by Rule 151A to be ineligible for the Section 3(a)(8) exemption. RA179 (a "purchaser of an indexed annuity assumes investment risk because his or her return is not known in advance"). Moreover, the Commission explained that this is an investment risk the Securities Act was intended to address through disclosures to investors. RA172-73; RA177-79. The Commission carefully limited the reach of Rule 151A to those indexed annuities in which it is "more likely than not" that investors will be subjected to the investment risk created by uncertain returns linked to a fluctuating securities index. RA180.

In assessing investment risk (including the relative allocation of risk), the Commission also considered the practical abilities of insurers and contract purchasers to manage their respective exposures to investment risk. RA180-81. As noted above, for insurers, these include such measures as resetting annually the formula for crediting index-linked returns and purchasing options and other derivatives to hedge against positive index changes. RA180-81. The Commission concluded that insurance companies can use these tools to effectively "reduce or eliminate their investment risks." RA180-81.

Marketing. The Commission did not explicitly incorporate a marketing factor into Rule 151A. RA184. Instead, consistent with the concern the Commission expressed a decade earlier in the 1997 concept release, see supra pp. 19-20, the Commission explained that a separate marketing factor was unnecessary, because "[t]he very nature of an indexed annuity, where return is contractually linked to the return on a securities index, is, to a very substantial extent, designed to appeal to purchasers on the prospect of investment growth." RA182-83. The Commission determined that it would be inconsistent with the character of indexed annuities described by Rule 151A, and potentially misleading, to market such annuities without placing significant emphasis on the securities-linked return and the related risks. RA183; see also RA151.

The Commission further stated its view that if purchasers were uninterested in the potential for growth offered by securities-linked returns in indexed annuities, they would opt for alternative investments offering higher fixed returns[14/]—a finding supported by data submitted by commenters. RA183.

State Insurance Laws. Responding to various comments that, unlike at the time the Securities Act was passed, state insurance regulation now addresses

---

[14] For example, the guaranteed rate of return in indexed annuities is typically much less than the rate of return offered on U.S. Treasury securities with a maturity term equal in length to the surrender charge period. JA457; see also JA242 n.4 (discussing NAIC STANDARD NONFORFEITURE LAW, § 4.B & 4.C).

"investor protection issues such as suitability and disclosure," the Commission explained that "the states' regulatory efforts, no matter how strong, cannot substitute for [the Commission's] responsibility to identify securities covered by the federal securities laws and the protections Congress intended to apply." RA191-92. To the extent that state insurance law has any relevance to the Section 3(a)(8) exemption, it is *only* " 'state insurance regulation as it . . . existed [in 1933].' " RA169 n.42 (quoting VALIC concurrence). The Commission also noted that, in any event, "[s]tate insurance laws, enforced by multiple regulators whose *primary charge* is the solvency of the issuing insurance company, cannot serve as an adequate substitute for uniform enforceable investor protections provided by the federal securities laws." RA192.[15/]

SUMMARY OF ARGUMENT

Rule 151(a) is based on a reasonable interpretation of the term "annuity contract" in Section 3(a)(8) of the Securities Act.

---

[15] Cf. FLORIDA DEP'T OF FINANCIAL SERVICES, EQUITY INDEXED ANNUITY INVESTOR ALERT (cautioning investors that because indexed annuities currently being sold are "*not required to be registered with the SEC*," issuers are not legally obligated to provide a "prospectus with disclosures regarding risk" and salespersons are not required to have "a securities license," but only need to have "taken and passed a 40-hour [insurance] licensing course and state life insurance exam").

1. The Chevron framework applies here because the Commission promulgated Rule 151A pursuant to its express statutory authority to adopt binding rules and regulations that define terms. The interpretation of "annuity contract" in Rule 151A is not unambiguously precluded by the statute. The Securities Act does not define "annuity contract," and the Supreme Court has made clear that the only contracts unambiguously covered by that term are the traditional fixed annuities that existed when Section 3(a)(8) was enacted. Because indexed annuities did not exist in 1933 and confront purchasers with investment risks that traditional fixed annuities do not, they are not unambiguously covered by Section 3(a)(8).

2. The Commission reasonably concluded that indexed annuities described by Rule 151A expose purchasers to investment risk that the Securities Act was intended to address through disclosure to investors and, therefore, are not the sort of annuity that Congress intended to leave exclusively to state insurance regulation through the Section 3(a)(8) exemption. The Commission reasoned that an indexed annuity in which the payout is more likely than not to be derived from the future performance of a securities index exposes an annuity purchaser to a significant investment risk, because his or her securities-linked return is not known in advance. This determination is consistent with case law, longstanding Commission interpretations, and common understanding of investment risk.

3. The Commission correctly concluded that none of the asserted burdens of Rule 151A on efficiency, competition and capital formation is a basis for altering its conclusion that an indexed annuity described by the Rule is not an exempt "annuity contract" under Section 3(a)(8). In any event, because the Commission adopted Rule 151A under its Section 19(a) authority to define terms, it was not required by the statute to analyze Rule 151A's potential impact on efficiency, competition and capital formation.

4. The arguments raised only by *amici curiae*—that the Commission did not adequately address Rule 151A's impact on small entities and that indexed annuities are not securities because they are not "investment contracts"—are not properly before the Court, because they address issues not raised by any party to this proceeding. In any event, neither has merit: the Commission adequately addressed Rule 151A's impact on small entities; and, under settled precedent, indexed annuities are investment contracts.

STANDARD OF REVIEW

Under the Administrative Procedure Act, 5 U.S.C. 706, this Court considers whether an agency action is arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law. The Commission's findings of fact are conclusive if supported by substantial evidence. Securities Act Section 9(a).

Under Chevron U.S.A., Inc. v. Natural Resources Defense Council, Inc., 467 U.S. 837, 842-44 (1984), this Court defers to the Commission's interpretation of the Securities Act if Congress has not "unambiguously forbidden [the interpretation] and it is . . . 'based on a permissible construction of the statute.' " Northpoint Tech. v. FCC, 414 F.3d 61, 69 (D.C. Cir. 2005) (quoting Chevron, 467 U.S. at 842-43); see also Consumer Electronics Ass'n v. FCC, 347 F.3d 291, 297 (D.C. Cir. 2003) (applying Chevron to whether FCC had authority to promulgate rule).

ARGUMENT

I. RULE 151A SHOULD BE UPHELD BECAUSE IT IS BASED ON A REASONABLE CONSTRUCTION OF AMBIGUOUS LANGUAGE IN SECTION 3(a)(8).

A. *Chevron* Controls the Court's Review of Rule 151A.

The Commission promulgated Rule 151A pursuant to Section 19(a) of the Securities Act, which delegates to the Commission the authority "to make . . . such rules and regulations as may be necessary to carry out the provisions" of the Act, including rules and regulations "defining accounting, technical, and trade terms . . . ." This provision expressly authorizes the promulgation of binding legal rules, and Rule 151A, which interprets "annuity contract" in Securities Act Section 3(a)(8), is such a rule. It is well settled that such agency action—undertaken pursuant to an "express congressional authorization[] to engage in the

process of rulemaking . . . that produces regulations" with the "force of law"—is subject to review under the analytical framework set out in Chevron. United States v. Mead Corp., 533 U.S. 218, 229-30 (2001); NCTA v. Brand X, 545 U.S. 967, 980-81 (2005).

There is no merit to any of the five arguments that Industry Petitioners advance (at 25-26) in an effort to avoid Chevron review.

First, in promulgating Rule 151A, the Commission invoked its express authority to define statutory terms under Section 19(a). In doing so, the Commission made clear that, contrary to Industry Petitioners' contention (at 25), it was exercising interpretative discretion. See, e.g., RA153 ("[W]e are adopting a new definition of 'annuity contract' that, on a prospective basis, will define a class of indexed annuities that are outside the scope of Section 3(a)(8). We carefully considered where to draw the line, and we believe that the line that we have drawn . . . is rational and reasonably related to fundamental concepts of risk and insurance.").

Distorting and misdescribing language in the Adopting Release, Industry Petitioners state that the Commission disclaimed any interpretative discretion by "asserti[ng] that . . . it was following the clear dictates of Section 3(a)(8)" and by stating that " 'Congress has determined that securities investors are entitled' to the

rule's requirements . . . ." IP Br. 50. In fact, the Commission explained that Rule 151A was necessary precisely because it was *unclear* whether the type of indexed annuity described by the rule is an "annuity contract" within the meaning of Section 3(a)(8). RA168-69. The Commission did not say that Congress has determined that securities investors are entitled "to the rule's requirements" (IP Br. 50) but, instead, "to the disclosure, antifraud, and sales practice protections of the federal securities laws." RA280. Accurately quoted, this statement does not reflect a Commission view that the rule was somehow preordained by Congress without any room for Commission interpretation.

Second, citing Akins v. FEC, 101 F.3d 731, 740 (D.C. Cir. 1997), vacated, 524 U.S. 11 (1998), Industry Petitioners erroneously argue that Chevron does not apply because the Commission "based [Rule 151A] on its interpretation of Supreme Court caselaw" instead of statutory terms. IP Br. 25. In Akins, this Court rejected the argument that an agency was entitled to Chevron deference in interpreting Supreme Court cases applying statutory terms that the agency conceded were unambiguous. 101 F.3d at 740. Here, by contrast, the Commission based Rule 151A on its interpretation of "annuity contract" in Section 3(a)(8)—a term that both the Supreme Court and the Commission have recognized is ambiguous when applied to types of annuities other than the traditional fixed

annuities that existed when the Securities Act was enacted. See supra, pp. 12, 14, 16, 17, 19, 20, 23.

Third, Industry Petitioners assert that Chevron deference does not apply because this case involves a " 'pure question of statutory construction' " (IP Br. 25), suggesting erroneously that statutory construction is somehow inconsistent with agency interpretations warranting deference. In fact, as National Association of Manufacturers v. Department of the Interior makes clear, the quoted language is merely a way of describing the first step of the Chevron analysis. 134 F.3d 1095, 1102 (D.C. Cir. 1998). For the reasons set forth below, the Commission concluded (consistently with every court to consider the question) that Section 3(a)(8) does not unambiguously address contracts—like the indexed annuities described in Rule 151A—that present investment risks beyond those found in the traditional fixed annuity contracts existing in 1933. As such, the Commission engaged in "statutory construction" of the same sort that the Supreme Court and this Court have consistently recognized as warranting Chevron deference: issuing a binding definitional rule that reasonably resolves ambiguities in a statute that an agency has authority to administer. See, e.g., Brand X, 545 U.S. at 980-81; National Mining Ass'n v. Kempthorne, 512 F.3d 702, 709 (D.C. Cir. 2008).

Fourth, the presence of the word "any" before "annuity contract" in Section 3(a)(8) does not strip the Commission of the interpretative discretion it has under Chevron regarding the meaning of that term. The contrary argument (IP Br. 25-26, 37-39) assumes erroneously that Congress intended to exempt from the protections of the securities laws any form of contract labeled (or regulated by a state as) an "annuity"—including those that did not exist when Section 3(a)(8) was enacted—without regard to the investment risks to which purchasers of such contracts are subjected. As discussed above at pages 14-16, the Supreme Court squarely rejected such a reading of Section 3(a)(8) in VALIC and United Benefit.

New York v. EPA, 443 F.3d 880 (D.C. Cir. 2006), does not support a contrary interpretation. In that case, the Court concluded that the placement of the word "any" before the words "physical change" in a Clean Air Act provision indicated that Congress intended to embrace all physical changes because, among other things, EPA had identified no "historical fact" contravening such a broad reading. Id. at 889-90. To the contrary, the factual evidence concerning Congress's intent when the provision at issue was enacted affirmatively supported the broader reading. Id. at 889; see also id. at 887. The Court also concluded that EPA could not "show that historical fact prevents a broad reading of 'any physical

change' inasmuch as EPA for decades ha[d] interpreted that phrase to mean 'virtually all changes, even trivial ones . . . .' " Id. at 889.

The sort of historical evidence missing in New York v. EPA supports the Commission's determination that the term "annuity contract" does not unambiguously apply to the indexed annuities described by Rule 151A. Indeed, because annuity contracts in 1933 were limited to traditional fixed annuities, it cannot be assumed that Congress would have intended new forms of contracts labeled "annuities" but presenting different investment risks to be eligible for the exemption created by Section 3(a)(8). VALIC, 359 U.S. at 67-73; id. at 75 (concurrence); see also United Benefit, 387 U.S. at 209-11. Since VALIC, the Commission and every court to address the scope of Section 3(a)(8) have uniformly regarded the exemption as applying unambiguously only to traditional fixed annuities. See supra pp. 12, 14, 16, 17, 19, 20, 23; see infra, pp. 38-39.

Finally, in promulgating Rule 151A, the Commission did not " 'expand its own jurisdiction' " or " 'invade the jurisdiction of other agencies' . . . [or] the jurisdiction of the States . . . ." IP Br. 26 (quoting American Bankers Ass'n v. SEC , 804 F.2d 739, 755 (D.C. Cir. 1986)). In American Bankers Ass'n, the Court held that the Commission could not use its definitional authority to gain jurisdiction over banks (by defining them as broker-dealers) because Congress had

clearly expressed its intent to "preclude SEC regulation of institutions meeting the statutory definition of 'bank' in order to avoid duplicative [federal] regulation." 804 F.2d at 744-45. None of the reasons underlying the Court's decision not to defer to the Commission interpretation at issue in American Bankers Ass'n applies here: the Securities Act does not define "annuity contract" at all, let alone in a way that is contrary to Rule 151A; subjecting indexed annuities described by Rule 151A to regulation as securities does not affect the jurisdiction of any other federal agency or any state; and the Supreme Court has held that Section 3(a)(8) does not reflect a congressional intent to exempt annuity contracts merely because they are subject to state insurance regulation. See United Benefit, 387 U.S. at 210; VALIC, 359 U.S. at 75 (concurrence).[16/]

B. Rule 151A Satisfies the First Step of the *Chevron* Analysis, Because Section 3(a)(8) Does Not Unambiguously Foreclose the Commission's Interpretation.

Under Chevron, "[i]f the intent of Congress is clear, that is the end of the matter; for the court, as well as the agency, must give effect to the unambiguously expressed intent of Congress." Chevron, 467 U.S. at 842-43. In Rule 151A, the

---

[16] Chevron applies even though the definition of "annuity contract" in Section 3(a)(8) could be seen as relating to the scope of the Commission's jurisdiction. See Mississippi Power & Light Co. v. Moore, 487 U.S. 354, 381-82 (1988) (Scalia, J., concurring) (citing cases).

Commission defined "annuity contract" in Section 3(a)(8) as not including an indexed annuity under which a purchaser is more likely than not to receive a payout in excess of the minimum guaranteed under the contract because of returns calculated retrospectively (that is, at the end of the period for which a return is to be credited) based on the performance of a securities-linked index during that period. Because that interpretation is not unambiguously precluded by the statute, Rule 151A passes the first step of the Chevron analysis. See Brand X, 545 U.S. at 996-97.

As the Commission explained (RA169-70), the Securities Act does not define "annuity contract," and, at the time Section 3(a)(8) was enacted, the type of indexed annuity that is described in Rule 151A did not exist. Thus, the Commission correctly concluded—just as the Supreme Court did when it considered the application of Section 3(a)(8) to the "annuity" contracts at issue in VALIC and United Benefit—that whether Congress would have intended Section 3(a)(8) to apply to the indexed annuity contracts addressed in Rule 151A cannot be discerned from the language of the statute alone. In VALIC and again in United Benefit, the Court held that the contracts at issue in those cases, though labeled "annuities," were not unambiguously covered by the term "annuity contract" in Section 3(a)(8). The Court reasoned that when Section 3(a)(8) was

enacted, the type of annuity contract then existing provided for a series of fixed payments and placed no substantial investment risks on purchasers, and, therefore, such fixed annuities are the only types of contracts unambiguously covered by the exemption. VALIC, 359 U.S. at 620-23; id. at 624 (concurrence).

With regard to new forms of contract that are called "annuities" but present different risks to purchasers—like the variable annuity in VALIC and the "Flexible Fund Annuity" in United Benefit—whether the Section 3(a)(8) exemption applies depends on whether the contract presents the sort of investment risks to which Congress then would have intended the protections of the securities laws to apply. See VALIC, 359 U.S. at 75 (concurrence); United Benefit, 387 U.S. at 209-11.

Following the Supreme Court's lead in VALIC and United Benefit, no court has held that Section 3(a)(8) unambiguously covers any annuity contracts other than traditional fixed annuities—in which the only risk to purchasers is that "the seller's portfolio will perform too poorly to finance the promised payments." Associates in Adolescent Psychiatry v. Home Life Insurance Co. ("Home Life"), 941 F.2d 561, 566 (7th Cir. 1991); id. at 567 (in all other cases an assessment of the risk remaining with the annuity purchaser is required because the application of

Section 3(a)(8) to such contracts is uncertain); see also Holding v. Cook, 521 F. Supp.2d 832, 837 (C.D. Ill. 2007).

Even in Malone v. Addison Insurance Marketing, Inc.—the district court case on which petitioners principally rely (see IP Br. 19, 21, 35, 43, 46-47) and with which the Commission disagrees for the reasons discussed below at page 60 —the district court recognized that the language of Section 3(a)(8) does not unambiguously include indexed annuity contracts like those described by Rule 151A. 225 F. Supp.2d 743, 748-49 (W.D. Ky. 2002) ("Each analysis in this area therefore requires the Court's particular attention to the instrument at issue. The Court begins by discussing the relevant characteristics of fixed and variable annuities and then classifies the contract on the basis of the criteria applied by the Supreme Court and other circuits.").

As discussed above at pages 17, 19, 20-21, and 23, the Commission, too, has consistently recognized that whether an annuity other than a traditional fixed annuity is an "annuity contract" within the meaning of Section 3(a)(8) is uncertain.

Industry Petitioners assert that, notwithstanding the foregoing uniform precedent, the "plain meaning" of Section 3(a)(8) covers the indexed annuities described in Rule 151A. IP Br. 29. They argue that it is unnecessary to undertake the sort of facts-and-circumstances test conducted in VALIC and United Benefit

(and by the Commission in this rulemaking) because, unlike in VALIC and United Benefit, (1) the value of an indexed annuity contract is not "depende[nt] on the issuer's management of a fund in which the purchaser [is] a shareholder"; and (2) the indexed annuity contract is "subject to the full panoply of state insurance protections applied to traditional fixed annuities . . . ." IP Br. 29. This argument rests on a misreading of VALIC and United Benefit.

First, neither VALIC nor United Benefit held that the *only* way that a contract would fall outside the plain meaning of "annuity contract" in Section 3(a)(8)—and have to be "tested" to see if it is the sort of instrument Congress intended to exempt—is if it involves an issuer providing management of a separate investment fund. The insurer's investment management of a separate fund was an aspect of the contracts at issue in those cases, but the Supreme Court's reasoning was broader. See United Benefit, 387 U.S. at 210 (quoting VALIC, 359 U.S. at 75). At page 30 of their brief, Industry Petitioners distort the meaning of language from United Benefit: the Court did not hold that Congress intended the Section 3(a)(8) exemption to apply *unless* an investment's "value depends on the 'investment management' of the issuer." Instead, it is only when an investment labeled an annuity does not present any of "*the sort of problems that the Securities Act . . . (was) devised to deal with*" that a court could conclude that it plainly "falls

within the sort of investment form that Congress was then willing to leave exclusively to the State Insurance Commissioners." VALIC, 359 U.S. at 76 (concurrence). Although an insurer's management of a separate investment account is one factor that implicates the protections of the Securities Act (and other securities laws), it is by no means the only one. Accordingly, the absence of that factor does not mean that Section 3(a)(8) unambiguously applies to a particular form of investment.[17/]

As the Commission explained, the indexed annuities described by Rule 151A have features (an equity indexed component and retrospective determination of the index-linked credit) that subject purchasers to "the risk of an uncertain and fluctuating financial instrument, in exchange for participation in future securities-linked returns." RA171. Because of this, the Commission correctly concluded that such indexed annuities present risks beyond those in the fixed annuities existing when Section 3(a)(8) was enacted and therefore are not unambiguously covered by that exemption. RA170-72.

---

[17] To the extent Industry Petitioners (at 31 & n.4) and Allianz (at 5-6) are suggesting that the indexed annuities described by Rule 151A involve *no* investment management by the issuer at all, they are mistaken. An insurer's ability to satisfy its contractual obligations to indexed annuity purchasers depends on the insurer's ability to manage the investment of the payments made by those purchasers. See infra pp. 71-73; see also NAFA, WHITE PAPER, supra, at 11.

Industry Petitioners are likewise mistaken in arguing that in VALIC and United Benefit the Court's conclusion that the annuity contracts at issue were not within the plain meaning of "annuity contract" in Section 3(a)(8)—and thus had to be subjected to the facts-and-circumstances inquiry discussed above—hinged on the absence of generally-applicable state insurance regulation. IP Br. 31. Rather, the relevant inquiry for purposes of whether a contract is covered by Section 3(a)(8) is not whether it is subject to a particular level of state insurance regulation (see supra p. 27), but whether offering the contract raises issues the Securities Act was enacted to address in 1933 and that Congress was not then content "to leave exclusively to the State Insurance Commissioners." VALIC, 359 U.S. at 76 (concurrence); see also United Benefit, 387 U.S. at 210 (citing concurrence in VALIC, 359 U.S. at 75).[18/] Indeed, a comment letter filed in this rulemaking on behalf of four of the Industry Petitioners and *amicus* Allianz (see JA240 n.1) recognized that "United Benefit actually specifically ***rejected*** a weighing of state [insurance] regulation in the analysis . . . ." JA500 (emphasis in original). The

---

[18] See VALIC, 359 U.S. at 69 (holding that what the states were doing in terms of regulation was "not decisive" because "the meaning of 'insurance' or 'annuity' under these Federal Acts is a federal question."); id. at 75 (concurrence) ("Nor is it rational to assume that Congress thought that any business whatsoever regulated by a specific class of officials, the State Insurance Commissioners, would be for that reason so perfectly conducted and regulated that all the protections of the Federal Acts would be unnecessary.").

commenters further stated that they were "aware of no Section 3(a)(8) opinion in which a court purported to assess the sufficiency of state annuity regulation to determine whether the contracts at issue were annuities or securities for the purpose of the [Securities] Act." JA500 (internal citations omitted) (emphasis in original). The comment letter is correct on this point; the more recently adopted contrary view of Industry Petitioners and Allianz is not.

C. Rule 151A Satisfies the Second Step of the *Chevron* Analysis, Because It Reflects a Reasonable Interpretation of Section 3(a)(8).

Because Section 3(a)(8) is "ambiguous with respect to the specific question at issue"—whether contracts described by Rule 151A are "annuity contracts"—the Commission's interpretation of "annuity contract" in Rule 151A warrants deference so long as it is a "permissible," that is, "reasonable," construction of that term. Chevron, 467 U.S. at 843-44; see also Northpoint, 414 F.3d at 69 (a " 'permissible' construction [is] . . . [one that] is not arbitrary, capricious, or manifestly contrary to the statute"). In assessing Rule 151A under this standard, the Court will not set aside the Commission's reasonable interpretation in favor of an alternatively plausible (or even a better) one. See, e.g., Brand X, 545 U.S. at 980 ("If a statute is ambiguous, and if the implementing agency's construction is reasonable, Chevron requires a federal court to accept the agency's construction of the statute, even if the agency's reading differs from what the court believes is the

best statutory interpretation."). The Commission's construction of "annuity contract" in Rule 151A is consistent with Congress's intent when it enacted that provision, as well as past judicial and Commission interpretations of investment risk warranting the protections of the securities laws. The Rule therefore readily satisfies Chevron's reasonableness requirement.

1. The Commission's interpretation reflects a reasonable view of the investment risk borne by the purchasers of the contracts described by the Rule.

As discussed above, the Commission determined that the purchaser of an indexed annuity described by Rule 151A "is exposed to a significant investment risk" because his or her return, which is linked to a securities index, "is not known in advance." RA179. Specifically, by announcing the index-linked return to be credited only at the *end* of the period (i.e., retrospectively), indexed annuities leave the contract purchaser facing uncertainty as to whether any such return will be credited or, if so, how much will be credited; the purchaser bears the uncertainty of an index-linked return that "depends on market volatility and risk." RA171; see also RA197-98. The Commission determined that this is an investment risk that the Securities Act was intended to address through disclosure to investors and, therefore, that the indexed annuities described by Rule 151A are not exempt under Section 3(a)(8). RA198-99; see generally Brand X, 545 U.S. at

980-81 ("[A]mbiguities in statutes within an agency's jurisdiction to administer are delegations of authority to the agency to fill the statutory gap in reasonable fashion," a task that involves "policy choices that agencies are better equipped to make than courts.").

Petitioners contend that the Commission based Rule 151A on a definition of investment risk that "is arbitrary, capricious, and contrary to law." IP Br. 39, 42. In fact, since adopting the Rule 151 safe harbor nearly a quarter century ago, the Commission has stated consistently that the uncertainty associated with the crediting of a return in excess of a contract's guaranteed return of principal and minimum interest is an investment risk. See RA22-23 (Rule 151(b)(3)). The Commission has further explained that if the rate of any excess return is determined prospectively—i.e., set in advance "for the next 12-month or longer period"—the insurer bears sufficient investment risk for the excess return to qualify for the safe harbor. RA19; see also RA17 (extending safe harbor protection where, among other conditions, the insurer prospectively announces an excess return rate that will remain in effect for at least one year). By contrast, the Commission has made clear that if the excess return rate is determined retrospectively (or if the insurer can modify a prospectively set rate "more frequently than once per year"), this shifts investment risk regarding fluctuations

in that rate to the contract owner. RA19; see also RA5; RA46-47. For that reason, the Commission decided not to extend the safe harbor to contracts that determine the excess return rate retrospectively. RA17; RA19; see also RA46-47.

Courts have also recognized that it is reasonable to treat the uncertainty arising from retrospective calculation of returns beyond the guaranteed minimum as an investment risk borne by purchasers. Courts have likewise concluded that such retrospective calculation is critical in assessing the applicability of the Section 3(a)(8) exemption. See, e.g., Home Life, 941 F.2d at 567; Rothwell v. Chubb Life Ins., 1998 U.S. Dist. Lexis 22630 (D. N.H. Mar. 31, 1998), *18-*20. In Home Life, Judge Easterbrook explained that—in contrast to such retrospective calculation—where the rate of any excess return is set in advance, the contract

> resemble[s] nothing so much as a series of fixed annuities, each one year in duration, with the purchaser having an option to renew. That the return is fixed for such a short period does not make the instrument less a[] [traditional] annuity.

Id. at 567.

Such *prospective* announcement of the excess return rate minimizes the purchaser's investment risk because it allows the purchaser intelligently "to withdraw all funds and invest them elsewhere, if dissatisfied with the rate; to leave the funds with [the insurer] and add nothing to them"; or "to make additional

purchases." Id.; see also Rothwell, 1998 U.S. Dist. Lexis 22630, at *19-*20 ("[A]dvance notice of rate changes gives [contract holders] a meaningful opportunity to assess whether they wish to continue to hold their policies."). Thus, like the holder of a traditional annuity, the purchaser of a product with a prospectively announced excess return rate avoids the uncertainty and investment risk of not knowing his or her return in advance. See Rothwell, 1998 U.S. Dist. Lexis 22630, at *20 ("This arrangement thus limits the extent to which investment risk is placed upon policy holders."). For contracts that prospectively announce the excess return rate, it is the insurance company, as opposed to the policy owner, that "assumes the risk that, despite its predictions, its investments will not perform sufficiently to meet its obligation to pay at the declared rate." Id. at *19; see also JA 488.

Courts have recognized, by contrast, that if a contract provides for the *retrospective* determination of an excess return rate, the insurer shifts investment risk to the contract purchaser. Id. at 19. For example, as Judge Easterbrook concluded in Home Life, the "*ex ante* uncertainty" created by retrospectively determined rates of return was the critical common characteristic of contracts that two earlier Seventh Circuit decisions held were ineligible for the Section 3(a)(8) exemption. 941 F.2d at 566-67 (discussing Peoria Union Stock Yards v. Penn

Mutual Life Ins., 698 F.2d 320 (7th Cir. 1983) and Otto v. VALIC, 814 F.2d 1127, 1133 (7th Cir. 1986)). Both cases involved contracts that offered a guarantee of principal plus a minimum rate of return, as well as excess return determined retrospectively (in Peoria, a *pro rata* share of the amount earned on the insurer's general portfolio of investments; in Otto, a discretionary amount determined by the insurer).[19]

When the rate of return is calculated retrospectively based on the performance of a securities index during a period, the insurer can enter into hedging contracts with third parties at the beginning of that period. RA180-81; see supra pp. 10-11; see infra p. 54. As the Commission concluded, this allows

---

[19] In April 1988, the Solicitor General's Office and the Commission supported a petition for *certiorari* in Otto. Without taking a position on the ultimate issue of whether the contract satisfied the Section 3(a)(8) exemption, the government's *amicus curiae* brief stated that the insurer "bore sufficient investment risk under the contract to meet the investment-risk criterion of Section 3(a)(8)" because the insurer guaranteed principal and a minimum rate of return, as well as the excess return declared under the contract. The brief did not address the retrospective determination of excess return rate as an investment risk relevant to determining whether a contract satisfies Section 3(a)(8). In this rulemaking, the Commission stated that the position articulated in the *Otto* brief is not relevant in the context of indexed annuities and, to the extent that the brief may imply otherwise, the position taken in the brief does not reflect the Commission's current position. RA181-82. See generally Brand X, 545 U.S. at 981 ("An initial agency interpretation is not instantly carved in stone. On the contrary, the agency . . . must consider varying interpretations and the wisdom of its policy on a continuing basis . . . .") (quoting Chevron, 467 U.S. at 863-64).

the insurer to reduce or eliminate its risk, while leaving the contract holder exposed to a significant investment risk—"the risk of a fluctuating and uncertain return based on the performance of a securities index." RA180-81; see also RA171. The Commission reasonably determined that, when indexed annuities are "more likely than not" to pay out based on retrospectively determined index-linked returns, the investment risk assumed by contract holders is significant enough to implicate the protective purposes underlying the securities laws. RA172; RA176; RA180-81.

Industry Petitioners nonetheless contend that the Commission's determination is unreasonable because, they claim, the Commission's understanding of investment risk "conflicts with the governing caselaw and common parlance." IP Br. 27. They argue, on this basis, that "investment risk is fundamentally" the risk borne by purchasers that their principal "will be lost or plummet in value." IP Br. 34. As the Commission explained, and the case law discussed above confirms, however, "[d]efining risk only as the possibility of principal loss or an approximate equivalent . . . fails to account for important forms of risk." RA177; see also Rothwell, 1998 U.S. Dist. Lexis 22630, at *16 ("investment risk" is "the risk that principal will be lost and/*or that the return on investment will be lower than expected*"); INTERNATIONAL GLOSSARY OF BUSINESS VALUATION TERMS (2001) ("Investment risk—the *degree of uncertainty*

as to the realization of expected returns.") (definition adopted by (among others) the American Institute of Certified Public Accountants). To demonstrate the point, the Commission explained that:

> accepting the definition of risk suggested by commentators as a complete characterization of risk would lead to the conclusion that any two assets that both guarantee return of principal equally have no risk. However, we believe that the market would generally view an asset where the future payoff of the amount over the guaranteed principal return is uncertain to be more risky than a zero-coupon U.S. government bond maturing at the same date, which also guarantees principal return but has a nearly certain future payoff.

RA177-78.

Indeed, the contention that investment risk in "common parlance" is nothing more than the loss of principal (IP Br. 2, 27, 37) is belied by petitioner NAIC's own recognition (in publicly disseminated materials prepared before the current litigation) that indexed annuities present a level of investment "risk" that falls between the "potential for higher earnings that aren't guaranteed" in variable annuities and the "guaranteed interest rate and little or no risk" of traditional fixed-rate annuities. NAIC Add.45 ("[A]m I somewhere in between and willing to take some risks with an equity-indexed annuity?"); see also JA297 (comparing risks and identifying—in a dozen questions that a prospective purchaser of

indexed annuities should ask—information relevant to assessing "how much risk [the purchaser is] willing to take with [his or her] money").

Moreover, even a quick internet search of the words "investment risk definition" yields results showing that the Commission's understanding is consistent with common usage: "uncertainty about the future benefits to be realized from an investment";[20/] "[t]he uncertainties attached while making an investment that the investment may not yield the expected returns";[21/] and "common definition for investment risk is deviation from an expected outcome."[22/] These definitions thus make clear that when the Commission spoke of the "uncertain and fluctuating returns" of indexed annuities (e.g., RA181) and their potential for "unpreditabl[e] deviat[ion] from the expected return" (e.g., RA177), it was using alternative, commonly accepted formulations for describing the investment risk posed by those products. See also RA179 ("The purchaser of an indexed annuity assumes investment risk because his or her return is *not known in advance* and therefore *varies from its expected value*.").

---

[20] See (http://financial-dictionary.thefreedictionary.com/Investment+Risk); (http://www.thecfdcentre.com/glossary/technical_and_fundamental_analysis/investment_risk); (http://www.advfn.com/money-words_term_7698_Investment_Risk.html).

[21] See (http://www.hjventures.com/valuation/Investment-Risk.html).

[22] See (http://www.investopedia.com/articles/08/risk.asp).

Industry Petitioners erroneously assert (at 40) that the only investment risk that concerned the Court in VALIC and United Benefit was loss of principal. Although those cases involved contracts in which there was a risk of loss of principal—albeit a small risk in United Benefit, where the contract guaranteed 100% of net premiums after 10 years—neither case foreclosed the possibility that a contract that eliminated *some* risk by guaranteeing principal might nonetheless present *other* investment risk that would make it ineligible for the Section 3(a)(8) exemption.

In another version of their loss-of-principal argument, Industry Petitioners also assert that indexed annuities present no investment risk to purchasers because there is no "downside risk," which, they state, is "[c]learly[] what would concern investors." IP Br. 40-41 (quoting ZVI BODIE, ET AL., INVESTMENTS, at 174 (2005)). However, downside risk is recognized as the risk that the actual return will be lower than the "expected return " (i.e., the mean of all the potential returns that could occur). See JOHN BLACK, OXFORD DICTIONARY OF ECONOMICS (2002) (defining "downside risk" as risk that the outcome "will be below the expected mean return"). In the case of the indexed annuities described by Rule 151A, which are "more likely than not" to produce a return that is greater than the minimum guaranteed value, the expected return will always be an amount *greater*

than the floor established by the minimum guaranteed value.[23/] The downside investment risk of such an indexed annuity comprises all the possible returns that are lower than the expected return and higher than the minimum guaranteed value.[24/] RA179.

---

[23] Industry Petitioners (at 40-41) rely on a report attached to their comment letter during the notice-and-comment period to support their contention that indexed annuities do not present downside risks because of the minimum guarantee. The report reaches this incorrect conclusion by erroneously—and without explanation—equating the minimum guaranteed value with the expected return, and thus supposing that all returns greater than the minimum guarantee reflect only upside risk. As discussed above, however, the expected return is necessarily greater than the guaranteed minimum for contracts described by Rule 151A.

[24] Industry Petitioners (at 40) appear to confuse the Commission's statement that investment risk exists where there is a potential for "unpredictabl[e] deviat[ion] from the expected return" (RA177), with the statistical term of art "standard deviation," which is used to *quantify* risk. See generally, e.g., DAVID R. ANDERSON, DENNIS J. SWEENEY, & THOMAS A. WILLIAMS, STATISTICS FOR BUSINESS AND ECONOMICS, at 75 (1993). The discussion in the treatise that the Industry Petitioners identify in support of their argument (at 40) refers to standard deviation and simply stands for the settled proposition that, the more a distribution departs from a normal distribution (bell curve), the less useful the standard deviation statistic is for *precisely quantifying* risk. See ZVI BODIE ET AL., supra note __, at 142. However, the Commission's analysis does not depend on precisely quantifying the investment risk presented by indexed annuities described by Rule 151A. *See* RA177-79. And, even if the distribution of possible returns of an index-linked contract takes a form other than a normal distribution (making standard deviation a less precise statistic for quantifying risk), this does not change the fact that there remains significant potential for deviation above or below the expected return, thereby generating uncertainty that is recognized as investment risk. RA179.

2. The Commission reasonably considered the allocation of risk between the insurer and the contract purchaser in contracts described by Rule 151A.

Contrary to Industry Petitioners' contention (at 18-19, 43-44), the Commission based Rule 151A on an assessment of the relative allocation of risk between the insurers and the contract holders. Indeed, as discussed above at pages 45-49, the distinction that the Commission relied upon between the retrospective and prospective determination of the index-linked rate of return rests upon the allocation of investment risk. The retrospective determination of the index-linked rate leaves the contract holder assuming the risk of the volatile and fluctuating market index, while allowing the insurer to substantially reduce or eliminate its investment risk of "having to pay" that index-linked return (IP Br. 18) by entering into hedging contracts with third parties. RA180-81.

Industry Petitioners also mistakenly contend (at 43-44) that the Commission's assessment of the allocation of risks failed to take account of the insurer's risk associated with guaranteeing principal and minimum interest. In fact, the Commission explained (RA179-80) that the "more likely than not test" for determining whether an indexed annuity is identified by Rule 151A "specifically contemplates" the insurer's assumption of this risk:

> [T]he rule recognizes that where the insurer is more likely than not to pay an amount that is fixed and guaranteed by the insurer, significant

> investment risks are assumed by the insurer and such a contract may therefore be entitled to the Section 3(a)(8) exemption. Conversely, where the purchaser is more likely than not to receive an amount that is variable and dependent on fluctuations and movements in the securities markets, rule 151A recognizes the significant investment risks assumed by the purchaser and specifies that such a contract would not be considered to fall within Section 3(a)(8).

RA180.

This is a reasonable way of taking account of the risks respectively borne by insurers and purchasers in an indexed annuity. If the amount paid to a purchaser is more likely than not to be the minimum guarantee—for which the *insurer* bears the risk—the contract may be eligible for the 3(a)(8) exemption. Conversely, if the payout under the indexed annuity is more likely than not to be determined based on a retrospectively credited index-linked return—the only situation covered by Rule 151A—the *purchaser* principally bears the risks flowing from uncertain and volatile market fluctuations, and the contract therefore is not eligible for the 3(a)(8) exemption.

3. The Commission reasonably considered the marketing of the contracts described by Rule 151A.

Contrary to Industry Petitioners' argument (at 45-46), the Commission reasonably concluded that it was unnecessary for Rule 151A to address specifically the manner in which indexed annuities described by the Rule are marketed, because indexed annuities are inherently designed to appeal to

purchasers based on the prospect of investment growth through participation in securities-linked returns. RA182-84. The Commission determined that, at least in the case of indexed annuities defined by Rule 151A as ineligible for the Section 3(a)(8) exemption—i.e., those in which the returns will more likely than not be index-linked—"[i]t would be inconsistent with the character of such an indexed annuity, and potentially misleading, to market the annuity without placing significant emphasis on the securities-linked return and related risks." RA183; see also JA489-90 (comment letter of AXA Equitable Life Ins., Hartford Financial Services Group, Massachusetts Mutual Life Ins., MetLife Inc., & New York Life Ins., dated Oct. 7, 2008) (same)). The Commission also cited recent data showing that a substantial percentage of those purchasing such products identified the prospect of growth as a reason for their purchase. RA183.

Neither the Commission nor any court has held that a contract that otherwise is ineligible for the Section 3(a)(8) exemption could nonetheless *become* eligible for that exemption based on the way the contract is marketed. Thus, although courts and the Commission have considered marketing in the past, it has been viewed only as a one-way ratchet—i.e., a disqualifying factor—for entitlement to the exemption. See, e.g., Grainger v. State Security Life Ins., 547 F.2d 303, 306 (5th Cir. 1977) (marketing is relevant "in ascertaining that items

which intuitively would *not* seem to be securities are, in reality, securities within the meaning of the federal Acts"); RA22 (Rule 151(a)(3) provides that a contract is ineligible for the Rule 151 "safe harbor" if "[t]he contract is . . . marketed primarily as an investment"). The Commission reasonably concluded that separately considering marketing is unnecessary with regard to indexed annuities described by Rule 151A both because the investment risk remaining with purchasers of such contracts renders the contracts ineligible for the Section 3(a)(8) exemption and because, as set forth above, truthful marketing of such products would have to emphasize the investment aspect of the contract—the potential for uncertain index-linked returns—that gives rise to that risk.

4. Rule 151A is consistent with Rule 151.

The argument that Rule 151A is arbitrary and capricious because it conflicts with Rule 151 (IP Br. 46-47) is based on a misreading of the release the Commission issued when it adopted Rule 151. In promulgating Rule 151 and subsequently, the Commission has explained that the Rule 151 safe harbor is available only where—unlike in indexed annuities described by Rule 151A—a rate of return set by reference to an index is determined *in advance* of the period in which the rate will apply. That interpretation of Rule 151, which petitioners dispute, is entitled to deference. See Capital Network System, Inc. v. FCC, 28

F.3d 201, 206 (D.C. Cir. 1994). Placed in context, the last sentence of the following excerpt from the Rule 151 adopting release—on which Industry Petitioners base their argument (at 47)—fully supports the Commission's interpretation of Rule 151:

> [T]he Commission has determined that it would be appropriate to extend the rule to permit insurers to make limited use of index features in determining the excess interest rate, so long as the excess rate is not modified more frequently than once per year. The insurer, therefore, would be permitted to specify an index to which it will refer, no more often than annually, to determine *the excess rate* that it will guarantee under the contract for the *next* 12-month or longer period. Once determined, *the rate* of excess interest credited to a particular purchase payment or to the value accumulated under the contract *must remain in effect for at least the one-year time period established by the rule*. Thus, while the rate of interest calculated under a particular index or formula may fluctuate upward or downward on a daily basis, the excess interest rate actually credited may not fluctuate more than once per year.

RA19 (footnotes omitted).

This makes clear that, to qualify for the Rule 151 safe harbor, insurers that set a rate of return based on an external index may refer to such an index no more frequently than once a year "to determine the . . . *rate*"—i.e., set the actual rate to be credited—for the *following* crediting period of the contract. Thus, as the Commission explained, setting the rate by reference to the index must be done prospectively. RA72-73 & n.38; RA167 & n.38; RA185.

The last sentence of the foregoing excerpt does not mean, as Industry Petitioners urge, that indexed annuities identified by Rule 151A meet the requirements of Rule 151 because in such products "the *crediting method* is determined annually and interest is credited annually, though the index itself fluctuates daily." IP Br. 47. Read in context, that sentence does not support the view that it is enough for the "crediting method"—i.e., the formula for calculating the index-based return—to be determined in advance of the period for which such interest may be credited. Rather, the *actual rate* of return to be credited must be set by referring to the relevant index at the outset of the 12-month-or-longer period, and that rate must be applied during the entire period without regard to fluctuations in the index during that time. Because indexed annuities described by Rule 151A determine the index-linked rate only at the *end* of the period to which the rate applies, they do not qualify for the Rule 151 safe harbor, and the purported conflict that Industry Petitioners identify does not exist. To the contrary, Rule 151A is consistent with the Commission's determination in 1986 to exclude from Rule 151's safe harbor contracts which credit an excess return based on retrospective reference to an index but *otherwise* guarantee principal and a minimum return. That judgment gave substantial weight to the risk borne by a

purchaser under the portion of the contract that provided for a return *other than* the guaranteed principal plus minimum interest.

As the Commission explained (RA185; see also RA72-73, n.38), the court in Malone erred when it concluded that an indexed annuity fell within the Rule 151 safe harbor. *See* 225 F. Supp.2d at 752-54. Contrary to Industry Petitioners' suggestion (at 46-47), that decision offers no basis for questioning the reasonableness of the Commission's construction of Rule 151, because the district court ignored the fact that the indexed annuity at issue in that case (like those described by Rule 151A) apparently provided for determining the rate of any index-linked return to be credited only at the *end* of the relevant crediting period. See Malone, 225 F. Supp.2d at 753; see also Stephen E. Roth, The Securities Status of Life Insurance Products, 902 PLI/COMM 169, 197 (Jan. 2008) ("The [Malone] court did not reconcile its conclusion that the contracts met Rule 151 with the SEC's explicit statement that the retroactive crediting of interest would place a contract outside the protection of the safe harbor of Rule 151."). Thus, the court did not address the reason why the Commission concluded such contracts are ineligible for the Rule 151 safe harbor, let alone offer any reason to doubt the Commission's interpretation.

5. The remaining challenges to the reasonableness of the Commission's interpretation of Section 3(a)(8) are meritless.

a. Rule 151A does not intrude on the states' regulation of contracts described by the Rule.

The argument (IP Br. 44-45; NAIC Br. 12-13) that Rule 151A "intrudes" on state insurance regulation misconceives the effect of Rule 151A and rests on a view of the relationship between the federal securities laws and state insurance regulation that the Supreme Court has rejected. Industry Petitioners argue (at 44-45) that Rule 151A is effectively "mandat[ing]" that insurance companies structure their contracts in a way that provides "a 'guarantee' higher than required" by state insurance regulators and thereby interfering with state regulation of those products. This is not so. Rule 151A does not mandate any contract structure; it simply makes clear that ***if*** a contract is structured in a particular way, it will be ineligible for the exemption under the Securities Act created by Section 3(a)(8). An insurer may elect to modify the structure of an indexed annuity it issues in such a way that the contract no longer falls within the class that Rule 151A describes, and such modifications may exceed what is required to comply with applicable state insurance laws, but this does not mean that the Rule is "intruding on" state law. The requirements of the state insurance

laws remain in full force. As discussed below at pages 64-65, such concurrent state and federal regulation was anticipated by Congress.

NAIC's similar argument that Rule 151A's "reclassification of a traditional insurance product as a security through the adoption of Rule 151A is in direct conflict with Congress'[s] specific grant of authority to the states" (at 12-13) is plainly wrong and inconsistent with VALIC and its progeny. Rule 151A does not preempt *any* state insurance law; indexed annuities described by the Rule remain subject to all applicable insurance laws. Moreover, the Supreme Court squarely held that construing Section 3(a)(8) as not applying to a product that states regulate as insurance does not run afoul of the McCarran-Ferguson Act or states' prerogatives as insurance regulators. See VALIC, 359 U.S. at 68; see also RA168-69 n.40.

b. Rule 151A is reasonably limited to contracts that create a contractual obligation to pay an index-linked return.

There is no merit to the argument that Rule 151A is arbitrary and capricious because, by its terms, it does not apply to "traditional fixed annuities and 'discretionary excess interest contracts'. . ." even though both types of contracts (like indexed annuities) may include rates of return that are based in some way " 'on the performance of the securities held by the insurer's general account.' "

IP Br. 48 (quoting RA197). As the Commission explained (RA197), unlike indexed annuities, traditional and discretionary excess interest annuity contracts do not contractually require that the rate of return be set by reference to the performance of a security or group of securities. This aspect of indexed annuity contracts—together with their retrospective calculation of the indexed-linked rate of return—subjects purchasers to the uncertain trajectory of the securities market, an investment risk not present in traditional and discretionary excess interest annuity contracts. RA197-98. It was reasonable for the Commission to limit Rule 151A to indexed annuities both because that investment risk *necessarily* exists where contracts are structured in the manner described by the Rule, and because the rulemaking was undertaken for the express purpose of addressing the uncertain regulatory status of this type of annuity. See Star Wireless LLC v. FCC, 522 F.3d 469, 475 (D.C. Cir. 2008) ("[A]n agency need not address all problems at once . . . Instead, its rules may solve first those problems it prioritizes.").

II. THE ARGUMENTS BASED ON ALLEGED DEFECTS IN THE COMMISSION'S ANALYSIS OF THE RULE'S IMPACT ON EFFICIENCY, COMPETITION AND CAPITAL FORMATION ARE MERITLESS AND, IN ANY EVENT, IRRELEVANT AS A MATTER OF LAW.

There is no merit to the contention (IP Br. 49-51; NAIC Br. 14-15) that the Commission contravened Section 2(b) of the Securities Act, 15 U.S.C. 77b(b), by not adequately analyzing Rule 151A's potential impact on efficiency, competition,

and capital formation. As demonstrated below, the Commission appropriately analyzed the applicability of those factors and properly rejected the arguments petitioners raise. Further, the plain language of Section 2(b) makes clear that the Commission was not statutorily required to undertake that analysis and, thus, any alleged defects cannot be a basis for challenging the rule.

A. The Commission Considered and Properly Rejected Petitioners' Contentions Regarding the Rule's Impact on Efficiency, Competition, and Capital Formation.

Petitioners contend that the Commission was required both to determine the extent to which state insurance laws afford similar protections and to justify what additional benefits application of the federal securities laws would provide. See IP Br. 49-51; NAIC Br. 13-15; Wasserman Br. 14-18; Allianz Br. 10-12. The Commission properly rejected this attempt to use Section 2(b) to escape the Supreme Court's holdings in VALIC and United Benefit that, with respect to new products labeled annuities, what the states are doing in terms of regulation is *not relevant* to whether those products qualify for the Section 3(a)(8) exemption. See, e.g., United Benefit, 387 U.S. at 211 ("adequate state regulation" is not a basis for the Section 3(a)(8) exemption); VALIC, 359 U.S. at 75 (concurrence) ("[H]owever adequately State Securities Commissioners might regulate an investment, [that investment] was not for that reason to be freed from federal regulation."); see also

supra p. 27. To the contrary, as Justice Brennan explained, "[c]oncurrent regulation . . . was contemplated by the [Securities Act] as a quite generally prevailing matter." VALIC, 359 U.S. at 75. In light of this, the Commission reasonably concluded that the general terms of Section 2(b) did not require it to consider what the states are doing in terms of regulation, because the Supreme Court long ago made clear that state regulatory approaches to new products are not relevant to the Section 3(a)(8) analysis.[25]

Accordingly, the Commission properly rejected commenters' concerns regarding potential duplicative regulation. The Commission reasonably concluded that state regulation "no matter how strong" could not "substitute for the federal securities law protections that apply to instruments that are regulated as securities." RA191-92. Those provisions "were designed to provide uniform protections, with respect to both disclosure and sales practices," while "[s]tate insurance laws [are] enforced by multiple regulators whose primary charge is the solvency of the issuing insurance company . . . ." RA191-92; RA279-80. As the

---

[25] Even if the general language of Section 2(b) could be construed to impose such a requirement, it would conflict with what the Supreme Court in VALIC and United Benefit held to be the specific framework set out by Congress in Section 3(a)(8) and, thus, would not be controlling here. See, e.g., Ohio Power Co. v. FERC, 954 F.2d 779, 784-85 (D.C. Cir. 1992) ("[I]t is black letter law that when a conflict arises between specific and general provisions of the same legislation, the courts should give voice to Congress's specific articulation of its policies and preferences.").

Commission explained, the purchasers of indexed annuities are "entitled to the disclosure, antifraud, and sales practice protections of the federal securities laws" (RA280, 281) without regard to whatever state-law protections might also apply to the same sellers, purchasers, and/or products.

Finally, Industry Petitioners (at 49-50) contend that the Commission did not adequately address comments that were received challenging the allegations of "widespread abusive sales" of indexed annuities. Although the "growth in complaints of abusive sales practices" was one factor that "persuaded [the Commission] that guidance is needed with respect to the[] status" of indexed annuities (RA59), the legal analysis under Section 3(a)(8) does not hinge on the actual "presence or absence of sales practice abuses." RA187. As the Commission explained:

> Where an annuity contract is entitled to the Section 3(a)(8) exemption, the federal securities laws do not apply, and purchasers are not entitled to their protections, regardless of whether sales practice abuses may be pervasive. Where, however, an annuity contract is not entitled to the Section 3(a)(8) exemption, which we have concluded is the case with respect to certain indexed annuities, Congress intended that the federal securities laws apply, and purchasers are entitled to the disclosure and suitability protections under those laws without regard to whether there is a single documented incident of abuse.

RA187. Neither the Commission nor any court has stated that the presence or

absence of sales practice abuses is relevant to whether an instrument is eligible for the Section 3(a)(8) exemption.

B. In any Event, the Commission Was Not Required by the Statute To Conduct the Analysis of Efficiency, Competition, and Capital Formation.

The challenges to the Commission's analysis of Rule 151A's potential impact on efficiency, competition, and capital formation fail for the additional reason that, under the unambiguous language of Section 2(b), the Commission was not required to undertake such an analysis when it promulgated Rule 151A. Section 2(b) provides that "the Commission shall also consider, in addition to the protection of investors, whether the action will promote efficiency, competition, and capital formation" when the Commission is engaged in rulemaking under a provision of the Securities Act that expressly "*require[s]*" the Commission "to consider or determine whether an action is necessary or appropriate in the public interest . . . ." The Commission adopted Rule 151A pursuant to its authority under Section 19(a), quoted above at page 30, which—unlike many other provisions in the Securities Act [26]—*does not* contain the statutory predicate that Section 2(b)

---

[26] Securities Act Sections 2(a)(10), 3(a)(2), 3(b), 3(c), 7(a), 7(b)(1), 7(b)(2), 8(a), 8(c), 8A(c)(1), 10(a)(4), 10(b), 10(c), 10(d), 19(b)(1)(A)(v), and 28 require the Commission to consider or determine whether the action is necessary or appropriate in the public interest.

sets for requiring the Commission to consider the potential impact of a rule on efficiency, competition, and capital formation. As such, any alleged defect in the Commission's analysis of those factors is not a basis for challenging Rule 151A.

III. THE ARGUMENTS RAISED ONLY BY *AMICI* ARE PROCEDURALLY DEFECTIVE AND MERITLESS.

A. Wasserman's Argument That the Commission Did Not Adequately Address the Rule's Impact on Small Businesses Is Not Properly Before the Court and Is Meritless.

Wasserman challenges the Commission's analysis under the Regulatory Flexibility Act, 5 U.S.C. 601, *et seq.* ("RFA"), as applied to small entity insurance distributors. Wasserman Br. 5-11. Because this issue was not raised by any party to this proceeding, it is not properly before the Court. See, e.g., Narragansett Indian Tribe v. National Indian Gaming Comm'n, 158 F.3d 1335, 1338 (D.C. Cir. 1998) (declining to consider issues raised only in an *amicus* brief filed by a Member of Congress); see also New Jersey v. New York, 523 U.S. 767, 781 n.3 (1998) (court refused to consider argument of *amicus* addressing an issue raised only by the *amicus* and not any party).

In any event, Wasserman's argument is based on a misreading of the Adopting Release and the RFA. In the Adopting Release (RA288-98), the Commission analyzed the RFA's compliance requirements, commenters' concerns, and significant alternatives as these relate to insurance distributors, even

though it was not required to do so because the Rule does not apply to insurance distributors.[27] Wasserman does not contest the Commission's analysis of these factors, which was clearly adequate. See, e.g., Valuevision Int'l, Inc. v. FCC, 149 F.3d 1204, 1213 (D.C. Cir. 1998). Rather, Wasserman argues (at 5-11) that the Commission was arbitrary and capricious in its "estimate of the number of small entities to which the rule will apply" because, Wasserman claims, the Commission rejected commenters' estimates of the number of small entity insurance distributors that will be affected by Rule 151A, and failed to conduct its own investigation into that number.

In making this argument, Wasserman erroneously ignores the fact that the Proposing Release specifically requested comments on the number of small entity

---

[27] The Commission correctly determined that small entity insurance distributors are not subject to the Rule. "[T]he language of the [RFA] limits its application to the 'small entities' which will be subject to the proposed regulation'—that is, those 'small entities to which the . . . rule will apply.' " Cement Kiln Recycling Coal. v. EPA, 255 F.3d 855, 869 (D.C. Cir. 2001); see also id. 869 (affirming agency's determination that rule applied only to entities the rule directly regulated, even though agency considered the economic effects of the rule on other small business entities); Motor & Equip. Mfrs. Ass'n v. Nichols, 142 F.3d 449, 467 (D.C. Cir. 1998) (RFA analysis was required regarding only entities directly regulated by the rule). Rule 151A defines a type of indexed annuity contract issued by an insurance company that does not fall within the Section 3(a)(8) exemption from the Securities Act. Because none of the insurers currently issuing indexed annuities are small entities, the Commission indicated in proposing and adopting the Rule that "there are no small entities among the insurers who are subject to the [Rule] . . . ." RA137; RA292-93.

distributors that might be affected by Rule 151A. RA142. This satisfied the Commission's obligations under the APA. See Nat'l Ass'n of Regulatory Utility Comm'rs v. FCC, 737 F.2d 1095, 1124 (D.C. Cir. 1984). Further, in noting that there "may be a substantial number of small entities among distributors of indexed annuities," the Commission cited a portion of the Adopting Release in which the Commission recognized commenters' estimate of "the number of small entities to be adversely affected by this rule to range from thousands to tens of thousands of small entities," and cited these comment letters. RA290 & n.306. In other words, the Commission sought and then credited commenters' estimate by citing both footnote 306 (which listed the comment letters) and the accompanying text (which mentions commenters' estimated range of affected small entity insurance distributors) as support for its finding that there may be a "substantial number" of these entities.[28/]

[28] Wasserman also asserts erroneously (at 10) that the Commission estimated that the rule would result in each agent that sells indexed annuities incurring costs of $250,000 to $3 million to "obtain and maintain broker dealer licenses." In fact, $250,000 to $3 million represents a range of cost estimates for the establishment of a registered broker-dealer firm by a distributing entity and not by an individual agent. RA270.

B. Allianz's Argument That Indexed Annuities Are Not Securities Under *Howey* Is Not Properly Before the Court and Is Meritless.

Amicus Allianz argues (at 4-6) that an indexed annuity described by Rule 151A is not a security because it does not fall within the definition of "investment contract" as construed by the Supreme Court in SEC v. W.J. Howey Co., 328 U.S. 202 (1946), and its progeny. Allianz concedes that this issue was not raised by any party to this case. Allianz Br. at C-2; Allianz Mot. at 2. As set forth above, this issue therefore is not properly before this Court.

In any event, contrary to Allianz's contention, the indexed annuities described by Rule 151A fall squarely within the definition of "security" because they are investment contracts under settled precedent. See, e.g., VALIC, 359 U.S. at 67-68 ("the term 'security'" is "broad enough to include any 'annuity' contract"); Home Life, 941 F.2d at 565 ("[A]nnuity products are securities, broadly understood, because they entail entrusting money to the hands of others in pursuit of appreciation"); see also RA172-73. The "touchstone" of an investment contract is "the presence of an investment in a common venture premised on a reasonable expectation of profits to be derived from the entrepreneurial or managerial efforts of others." SEC v. Edwards, 540 U.S. 389, 395 (2004).

The sale of indexed annuities plainly constitutes an "investment in a common venture premised on a reasonable expectation of profits." The purchasers

of the indexed annuities provide funds to an insurer which, in turn, uses those funds to acquire securities, including hedging contracts, for its general account. General account assets ultimately are used to cover the future payout obligations under the indexed annuities. See Home Life, 941 F.2d at 565 (all annuities "are pooled investment vehicles"); NAFA, WHITE PAPER, supra, at 11 ("An insurance company invests the premiums received from [indexed annuities] in its general account. All general account assets support the insurance company's obligations under the [indexed annuities]. . . ."). Similarly, insurers that issue indexed annuities are responsible for the entrepreneurial and managerial efforts that are essential to the insurers' ability to meet their obligations under the indexed annuities. For example, each such insurer enters into options and futures contracts in an effort to "accurately hedge its obligations to credit index-derived interest," and also undertakes to acquire and manage a sufficient level of "fixed income securities to support [the minimum guaranteed value]" of the indexed annuities. Id.

Allianz erroneously contends that "federal courts have found no securities to be involved where profits were dependent upon the fluctuations" of markets. Allianz Br. 6 (citing SEC v. Belmont Reid & Co., 794 F.2d 1388 (9th Cir. 1986) & NOA v. Key Futures, Inc., 638 F.2d 77 (9th Cir. 1980)). Neither case stands for

this sweeping proposition and, in any event, both cases are distinguishable. Those cases involve defendants that offered to purchase and process metal ore (gold and silver) and thereafter deliver the refined product to pre-paid purchasers, who could earn a profit only by themselves reselling the ore at a market price above the earlier purchase price paid to defendants. As the Ninth Circuit explained, the purchasers' ability to do this depended on the "fluctuat[ing]" market price for the ores at the time of resale. Belmont Reid, 794 F.2d at 1390; Key Futures, 638 F.2d at 79. This is not true of indexed annuities described by Rule 151A—and thus Belmont Reid and Key Futures have no application here—because (as discussed above) the payout under such contracts depends on the managerial efforts of the insurance company to cover its obligations to purchasers.

Accordingly, the equity indexed annuities described by Rule 151A satisfy the requirements for investment contract and, therefore, are securities.

CONCLUSION

For the foregoing reasons, the Commission's order should be affirmed.

Respectfully submitted,

DAVID M. BECKER
General Counsel

MARK D. CAHN
Deputy General Counsel

JACOB H. STILLMAN
Solicitor

____
MICHAEL A. CONLEY
Deputy Solicitor

DOMINICK V. FREDA
Senior Counsel

____
WILLIAM K. SHIREY
Senior Counsel

Securities and Exchange Commission
100 F. Street, NE
Washington, D.C. 20549-8010
(202) 551-5043 (Shirey)

April 2009

CERTIFICATE OF SERVICE

I hereby certify that on this 6th day of April, 2009, I caused two copies of the FINAL BRIEF OF THE SECURITIES AND EXCHANGE COMMISSION, RESPONDENT, to be served, via Federal Express overnight delivery, on each of the following:

Eugene Scalia
GIBSON, DUNN & CRUTCHER LLP
1050 Connecticut Ave, N.W.
Washington, D.C. 20036
(202) 955-8500

Rodney F. Page
BRYAN CAVE LLP
700 Thirteenth St., N.W.
Washington, D.C. 20005
(202) 508-6002

Kenneth W. Sukhia
SUKHIA LAW GROUP, PLC
2846 Remington Green Circle
Tallahassee, Florida 23308
(850) 383-9111

James F. Jorden
JORDEN BURT, LLP
1025 Thomas Jefferson St., N.W.
Suite 400 East
Washington, D.C. 20007
(202) 965-8100

Stephen Hall
NASAA, INC.
750 First Street, N.E.
Suite 1140
Washington, D.C. 20002
(202) 737-0800

Paul G. Cellupica
METLIFE , INC.
1095 Avenue of the Americas
New York, NY 10036-6796
(212) 578-4826

Deborah M. Zuckerman
AARP
601 E. St., N.W.
Washington, DC 20049
(202) 434-6045

____

William K. Shirey
Senior Counsel for the
Securities and Exchange Commission

CERTIFICATE OF COMPLIANCE

1. This brief complies with the type-volume limitations of FRAP 32(a)(7)(B) because:

this brief contains 16,869 words, excluding the parts of the brief exempted by FRAP 32(a)(7)(B)(iii).

2. This brief complies with the typeface requirements of FRAP 32(a)(5) and the type style requirements of FRAP 32(a)(6) because:

this brief has been prepared in a proportionally spaced typeface using WordPerfect 11 in 14 point Times New Roman type.

____

William K. Shirey
Senior Counsel for the
Securities and Exchange Commission

Dated: April 6, 2009