

MINUTES OF THE HOUSE FINANCIAL INSTITUTIONS.

The meeting was called to order by Chairperson Ray Cox at 3:30 p.m. on February 12, 2001 in Room 519-S of the Capitol.

All members were present except:

Committee staff present:

Dr. Bill Wolff, Legislative Research  
Bruce Kinzie, Revisor's Office  
Maggie Breen, Committee Secretary

Conferees appearing before the committee:

Whitney Dameron, Kansas Payday Loan Assn.  
Jerel Wright, Kansas Credit Union Department  
David Brant, Securities Commissioner  
Rick Fleming, Office of Securities Commissioner  
Carl Wilkerson, American Council of Life Insurers  
Rick Friedstrom, Kansas Association of Insurance  
and Financial Advisors  
Larry Magill, Ks. Association of Insurance Agents  
Amy Lee, Security Benefit Group

Others attending: See attached list

Chairman Cox opened the discussion on HB 2193 - Payday loans, limitation on number of loans to same borrower, which was amended by the House Committee of the Whole and re-referred back to the committee.

The Chairman asked **Whitney Dameron**, who represents the Kansas Payday Loan Association, if he had any comments on HB 2193. Whitney said the association he represents supports the original bill and has concerns with the amendments made on the House floor. Some other states have instituted a flat fee on payday loans which is a different issue than multiple loans which the Deputy Bank Commissioner is worried about. But a flat rate does seem to minimize the benefits of loan splitting. The amendments potentially further confuse the industry. He thinks its going in the wrong direction by over-complicating the statute on something that should be simplified.

The Chairman Cox asked **Kevin Glendening**, Deputy Bank Commissioner, what he thought of the amended bill. Kevin said that the amendments didn't affect what he wanted to do with the bill but he tended to agree with Whitney that it would confuse the issue.

Vice-Chairman Humerickhouse said an explanation for asking for the re-referral was that it was a little difficult to understand exactly what the amendment by Representative DiVita did. But in looking at what her amendment does, it drastically reduces the fees and interest that can be charged on loans. If he was in the business, he's not so sure he could afford to stay in it.

Representative Vickrey mentioned that there was also an amendment made by Ward Lloyd saying the notice to the borrower was to be in their native language.

Whitney Dameron said it might make for an interesting precedent. Perhaps then native language would be required on home mortgages, on consumer finance, and so forth.

Chairman Cox closed the discussion on HB 2193 and opened the hearing on HB 2252 - Credit union, rules and regulations, reserves.

**Proponent:**

**Jerel Wright**, Kansas Department of Credit Unions, spoke in favor of HB 2252. It amends two sections of Kansas credit union law. The first amendment is to K.S.A. 17-2217: Reserve income; payments into

CONTINUATION SHEET

MINUTES OF THE FINANCIAL INSTITUTIONS, Room 519-S Statehouse, at 3:30 p.m. on February 12, 2001.

reserve fund. The National Credit Union Administration enacted new federal regulations requiring minimum capital reserves for all credit unions throughout the U.S., including all state-chartered, federally insured Kansas credit unions. This amendment provides parity for all state-chartered credit unions by requiring compliance with federal law. Section 2 amends K.S.A. 17-2223a: Administrator's approval required before foreign credit union does business in state; examination; hearing. It provided the credit union administrator with authority to adopt rules and regulations. (**Attachment 1**)

Chairman Cox closed the hearing on **HB 2252** and asked for a motion on the bill.

Representative McCreary made a motion to pass out **HB 2252** favorably and, since it is of a non-controversial matter, place it on the consent calendar. Representative Sharp seconded the motion. The motion carried.

Chairman Cox opened the hearing on **HB 2243 - Regulating securities, powers of the commissioner.**

**Proponents:**

David Brant, Securities Commissioner, said **Rick Fleming**, General Counsel for the Office of the Securities Commissioner, would cover the amendments not dealing with variable annuities. Rick explained that Part A of the testimony has miscellaneous amendments which amend various statutes under the Kansas Securities Act to update or remove obsolete provisions, promote uniformity with other states' and federal securities laws. He pointed out several sections including: 1) Pg. 6, Ln. 16 which gives the commissioner broader discretion in determining whether the criminal convictions of an applicant warrant the denial of a securities license. The language allows the commissioner to take into account all convictions, not just felonies. And 2) Pg. 19, Lns. 31-42 which replaces obsolete immunity language by incorporating the new provisions concerning transactional immunity and use immunity. Part B covers the Use of Fines and Settlements for Investor Education. It establishes the Investor Educational Fund for the purpose of providing for the education of consumers in matters concerning securities regulation and investments. They think this would provide a valuable service and allow them to operate in a pro-active manner. Twelve other states have this provision and the Office of the Kansas State Bank Commissioner also has a similar fund. Part C covers Authority to Order Disgorgement and Restitution. It grants the commissioner the authority to order the disgorgement of illegal investment income and the payment of restitution to compensate investors for losses arising from violations of the securities laws. It also permits the commissioner to assess interest up to 15%, the same rate that is permissible in civil suits. (**Attachment 2**)

**David Brant**, covered Part D, Variable Products. A variable annuity is a hybrid product involving both investment and insurance components which is typically marketed as a long-term investment for retirement. It provides future payments, the amount of which depends on the performance of the portfolio's securities. The U.S. Supreme Court has ruled that variable insurance products are securities and subject to regulation by the S.E.C.. He presented the question "Is it unreasonable to treat this hybrid insurance/investment product the same under both state and federal law?" The Gramm-Leach-Bliley Act of 1999 provides for "functional regulation" of financial entities and their products. For a hybrid product, such as variable annuities, functional regulation requires split jurisdiction between securities and insurance at the same level as it does at the federal level. The purpose of the bill is not to impose any additional burden or cost to the insurance companies that package or the agents who sell variable annuities. Many agents currently have both securities and insurance licenses. For those who need to obtain a securities licenses, the annual fee is \$50. The bill will not add significant regulatory paperwork, fees or licenses. Most annuity firms and agents selling variable products will only be affected by this bill if there is a problem. The bill will provide better investor protection. He covered the content of letters from legal experts and licensed agents, as well as articles regarding variable annuities, which he also included in his written testimony. Commissioner Brant urged the committee to vote favorable on the bill. (**Also Attachment 2**)

**Jim Parrish**, Former Securities Commissioner, spoke in favor of the bill. He believes it is good consumer protection legislation and does not believe the bill would, as has been charged, place undue burden on the industry. He said it's important to look beyond the number of problem cases that involving the product and look at the people involved. Even though there may not be a crisis situation, he believes it is a crisis for that retired couples that lost money, because someone was unscrupulous, and there was no regulator to step in and help. He urged the committee to vote favorable upon the bill. (No written testimony.)



CONTINUATION SHEET

MINUTES OF THE FINANCIAL INSTITUTIONS, Room 519-S Statehouse, at 3:30 p.m. on February 12, 2001.

**Opponents:**

**Carl Wilkerson**, Chief Counsel - American Council of Life Insurers, representing 426 life insurance companies, said that they oppose the bill due to three troubling aspects. 1) **HB 2243** modifies the Kansas Insurance Commissioner's sole and exclusive authority to regulate the issuance and sale of variable life insurance and variable annuities. 2) It would subject variable life insurance and variable annuities to the Kansas Securities Code for the first time. And, 3) In scope and purpose, **HB 2243** governs matters substantially similar to those in **HB 2690**, which the Committee evaluated and rejected in February 2000. Nothing has occurred to warrant reconsideration of these issued in 2001. Variable life insurance and variable annuities are one of the most heavily regulated financial products in today's broad marketplace. The bill would disrupt a coordinated system of state and federal regulation established by the U.S. Supreme Court. It would cause duplicate registration of the same product. The need has not been justified. A pattern of abuse has not been identified. Expanded jurisdiction is not warranted. In reviewing five years of disciplinary action reports, only one involved the state of Kansas. Disciplinary action was taken. The system works. The Gramm-Leach-Bliley Act anticipated this kind of problem. They said that when you are dealing with a hybrid product that has dual characteristics (such as variable annuities or variable life which are part securities, part insurance), if it's defined in the Internal Revenue Service as insurance, it's regulated by the insurance commissioner. The purpose is to avoid duplicate overlapping regulation. He urged the committee to vote no to the proposed legislation. (**Attachments 3 and 4**)

**Rick Friedstrom**, Kansas Association of Insurance and Financial Advisors (KAIFA), is very, very much against the bill. The Kansas insurance agent, who is also a Registered Representative, is regulated quite heavily already. KAIFA does not see a clear and compelling reason for the legislation and urges the committee to vote in opposition to **HB 2243**. (**Attachment 5**)

**Larry Magill**, Kansas Association of Insurance Agents, talked in opposition to **HB 2243** saying most comments have been covered by previous conferees who oppose the bill. He did comment on the hybrid product issues. Variable life and annuities is a hybrid product but there are a lot of life and annuity products that have an investment element to them. They could also be categorized as a hybrid product. For example, universal life. There is side fund to universal life and it's a combination of term insurance and the side fund. If the insurance company does better on the guaranteed rate of return than the side fund, the insured benefits from it; and if the side fund does better, the side fund is used to flatten out the premium for universal life. If we're going to start dividing products, there could be a lot to divide. (**Attachment 6**)

**Amy Lee**, Security Benefit Life Insurance Company, testified that she has worked as an attorney at Security Benefit for 14 years, with her emphasis being on developing variable insurance product and variable insurance products compliance. The approach of regulating the product as insurance at the state level and as security at the federal level has worked well. She pointed out that most of the complaints that she has dealt with are of an administrative nature, such as incorrect addresses and something being processed incorrectly. There have been very few serious complaints over the years. The serious complaints have basically been that the consumers' rep didn't tell them everything they needed to know about a product. Those kind of complaints have been referred to the insurance department of the state involved and have been dealt with adequately. The insurance department has a very strong interest in getting those complaints resolved as the agents are agents of the insurance company. She requested the committee vote against the bill. (**Attachment 7**)

Chairman Cox closed the meeting on **HB 2243**.

Chairman Cox presented the minutes for the January 31 meeting. Representative Grant made a motion to approve the minutes as written. Representative Vickrey seconded the motion. The motion carried.

The meeting adjourned at 5:22 p.m.

The next meeting is scheduled for February 14.

# HOUSE FINANCIAL INSTITUTIONS COMMITTEE GUEST LIST

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NAME	REPRESENTING
Whitney Dameron	KS Payday Loan Assn.
Pat Leonard	Self/ KS Payday Loan Assn
George Barber	KAFS
Rick Friedman	KAFFA
David Halson	KS Ins Assns
John Crown	KAFFA
David Brant	Securities Commissioner
Rick Fleming	"
Wiley Kannarr	"
Amy Lee	Security Benefit
Roger Viola	" "
Jim Hall	ACLTE
CARL WINKERSON	ACHT
LARRY MAGILL	KS ASSN OF INS AGENTS
Colleen Muller	Kathy Dameron Assoc
Jeremy Anderson	KS Ins Dept
Linda DeCoursey	KS Ins Dept
Marlyn Berch	KS Ins Dept
Jin Liu	DOB







## Kansas Department of Credit Unions

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Bill Graves,  
Governor

Jerel Wright,  
Administrator

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### Testimony on House Bill 2252

From Jerel Wright

February 12, 2001

Mr. Chairman and members of the committee.

House Bill 2252 amends two sections of Kansas credit union law, K.S.A. 17-2217 and K.S.A. 17-2223a.

**Section 1 amends K.S.A. 17-2217: Reserve income; payments into reserve fund.**

On December 31, 2000, a new reserve requirement became effective for all credit unions. The National Credit Union Administration enacted new federal regulations requiring minimum capital (reserves) for all credit unions throughout the U.S., including all state-chartered, federally insured Kansas credit unions. This amendment provides parity for all state-chartered credit unions by requiring compliance with federal law.

**Section 2 amends K.S.A. 17-2223a: Administrator's approval required before foreign credit union does business in state; examination; hearing.**

The adoption of this amendment will provide the credit union administrator with the authority to adopt rules and regulations.

Currently, Kansas law allows the administrator to authorize a foreign credit union to do business in Kansas. Under rule and regulation authority, the department would establish specific conditions and standards necessary for a foreign credit union to operate within the borders of Kansas.



**HOUSE BILL No. 2243**  
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Washington University School of Law  
Reporter for the NCCUSL Drafting Committee

Letter from Richard Hite, Wichita Attorney  
NCCUSL Commissioner for Kansas

Letter from Fred Lovitch, Professor  
University of Kansas School of Law

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Article on Bonus Annuities (Forbes 2/19/01)

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NASD Regulation, Inc.

Letter from Jack Rosenfield, Former Director  
Kansas City office of NASD Regulation, Inc.

Letter from Betsy Rohleder of Securities America  
Kansas Agent licensed both with Insurance and Securities

Letter from Jim Reardon, Certified Financial Planner  
Kansas Agent licensed both with Insurance and Securities

SEC Investor Pamphlet on Variable Annuities

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**HOUSE BILL NO. 2243**  
**Summary and Explanation of Provisions**  
**Office of the Kansas Securities Commissioner**

**PART A:                   Miscellaneous Amendments**

Amend various statutes under the Kansas Securities Act to update or remove obsolete provisions, promote uniformity with other states' and federal securities laws.

Sec. 1                   K.S.A. 17-1252

Page 1, Line 41           Amend the definitions in subsections (e), (h), and (m)(1) for clarity. The  
Page 2, Line 17           amendments are not substantive, but the grammatical edits are important  
Page 3, Line 32           because the definitions are used for jury instructions and the current language is  
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Uniform Securities Act being considered by NCCUSL. Amend subsection (i) to add  
the Investment Adviser Act of 1940 to the list of federal statutes, because it is  
frequently cited in the act.

Sec. 2                   K.S.A. 17-1254

Page 4, Line 24           Amend subsection (b) to be consistent with subsection (a) regarding sales made in  
compliance with exemptions provided by KSA 17-1262.

Page 5, Line 7           Amend subsection (d) because the current language technically requires out-of-state  
firms to register all their investment adviser representatives in Kansas, even those  
IAR's who do not have customers in Kansas. The proposed language mirrors the  
language at the end of (d)(2).

Page 5, Line 26           Amend subsection (e) to delete obsolete language that expired on October 10, 1999.

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whether the criminal convictions of an applicant warrant the denial of a securities  
license. We increasingly see applicants with a series of misdemeanors or serious  
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Page 8, Line 10           Amend subsection (m) to delete obsolete language in subpart (2), and to clarify and  
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and investment advisers to reasonably supervise their agents, investment adviser  
representatives or other employees. The proposed amendment to (m)(12) is based on  
the Uniform Securities Act.



Sec. 2 K.S.A. 17-1254 (continued)

Page 9, Lines 26-39 Amend subsections (n) – (p) to add “investment adviser representatives” to all the provisions which list “broker-dealers, agents, and investment advisers.” Before the National Securities Market Improvement Act of 1996, the term “investment adviser” referred to both firms and individuals. Now the term “investment adviser” refers to the firm, and the term “investment adviser representative” refers to the individual. This portion of the statute has not been updated to take into account the change in terminology after NSMIA.

Page 10, Lines 1-39 Amend (p) to facilitate the use of a new “investment adviser registration depository” (IARD), a centralized computer system for investment advisers. It is similar to the “central registration depository” (CRD), a system that is already in place for broker-dealers and agents. The current language of the statute explicitly authorizes our participation in the CRD system. The proposed amendments broaden our authority and permits participation in any registration depository.

Sec. 3 K.S.A. 17-1257

Page 11, Line 1 Amend subsection (a) to clarify that registration of securities by coordination with federal registration at the SEC does not apply if the federal registration is already in effect at the time an application is filed in Kansas. Applications for registration of securities in Kansas filed after the federal registration is effective would need to be filed by Qualification under KSA 17-1258. The effect of this change is that securities already registered with the SEC could not become registered automatically in Kansas as provided under KSA 17-1257(c), but would become registered when ordered by the Commissioner. Amend subsection (b) for clarity, and to correct an error in the current wording of (b)(3), which says “of” rather than “or.” Amend subsection (c) for clarity, to delete superfluous language, to delete obsolete language permitting the use of a telegraph for notification, and to permit the agency to give notice to a registrant without charging the registrant for it. Subdivide paragraph (c) into new (c), (d), and (e).

Sec. 4 K.S.A. 17-1258

Page 14, Line 26 Amend subpart (a)(14) to update descriptions of financial statements in conformity with current generally accepted accounting principles, and add new (b) to provide that the Commissioner may require financial statements to be audited by independent certified public accountants in accordance with generally accepted auditing standards. The remaining proposed amendments edit for clarity and adopt neutral pronouns.

Sec. 5 K.S.A. 17-1261

Page 15, Line 9 Amend subsection (b) to adopt NCCUSL language and eliminate confusion arising from the use of the term “corporate” (i.e., securities issued by Canadian corporations are not exempt.) Delete subsections (n) and (o) which specify exempt securities issued by Kansas-based nonprofit organizations, because those provisions are non-uniform, redundant and confusing in relation to other exemptions and laws. The types of securities specified in these subsections are also exempt under subsection (h) of this

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Currently, 12 states, including the states of Delaware, Missouri, Utah and Wisconsin, allow fines and settlements for securities violations to be used for investor education.

**PART C: Authority to Order Disgorgement and Restitution**

Sec. 8 K.S.A. 17-1266a

Page 21, Line 2 Amendment enables the commissioner to order the disgorgement of illegal investment income and the payment of restitution to compensate investors for losses arising from violations of the securities laws. Also permits the commissioner to assess interest up to 15% (the same interest rate that is permissible in civil suits under K.S.A. 17-1268).

Fiscal Impact No additional staffing costs would be required. The restricted funds from disgorgement and restitution would not impact the agency budget because such funds are paid to investors.

Policy Impact The proposed legislation would enhance the Commissioner’s authority to order disgorgement and restitution. The additional authority would be subject to the Kansas Administrative Procedures Act so that alleged violators would have an opportunity for due process and the right to appeal findings of an administrative hearing.

**PART D: Variable Products**

“Financial modernization” is becoming a reality due to the federal changes contained in the Gramm-Leach-Bliley Act of 1999. Congress passed the Act to modernize the delivery of financial services by removing depression-era barriers that separate banking, securities, and insurance functions. The new federal act provides for “**functional regulation**” of financial entities and their products – banks by banking regulators, securities affiliates by the Securities and Exchange Commission (SEC) and state securities regulators; and insurance companies by state insurance regulators.

A variable annuity is a hybrid product involving both investment and insurance components which is typically marketed as a long-term investment for retirement. A variable annuity provides future payments, the amount of which depends on the performance of the portfolio’s securities.

The U.S. Supreme Court has confirmed that variable annuities are securities and are subject to regulation by the SEC. At the state level, the original version of the Uniform Securities Act adopted by Kansas included variable annuities and only excluded fixed annuities from the definition of securities. However, the Kansas law was amended in 1968, as it was in many states at the time, to also exclude variable annuities and to grant exclusive jurisdiction to the Insurance Commissioner.



Sec. 1 K.S.A. 17-1252

Page 1, Line 25 Amend subsection (b) to include agents who offer/sell variable products under the definition of "Agent" by inserting a reference to subsection (e) of KSA 17-1261 (as not excluded).

Page 3, Lines 4,6 Amend subsection (j) to include variable annuities issued by insurance companies under the definition of "Security" by amending the definition to exclude only fixed annuities.

Sec. 5 K.S.A. 17-1261

Page 15, Line 28 Amend subsection (e) to delete the following phrase at the end of the existing statute which provides an exemption from registration of securities issued or guaranteed by insurance companies: "...when such securities are sold by the issuer." With this change, securities issued by insurance companies will be exempt from registration regardless of who sells the securities, but the persons selling the securities would need to be registered.

Sec. 11 K.S.A. 40-436

Page 25, Line 41 Amend subsection (l) in the Insurance Code to clarify 1) that the Insurance Commissioner continues to retain **exclusive** jurisdiction over the issuers (insurance companies) and variable annuity contracts and 2) that agents selling variable annuities are now subject to functional regulation.

Fiscal Impact None anticipated at this time. If the bill is enacted, there would be some additional responsibility. However, the Securities Commissioner will not be asking for any additional budget authority for staff or other expenses.

Policy Impact The amendments will only allow functional jurisdiction by Securities and Insurance over the agents who sell variable annuities. Exclusive jurisdiction over the insurance companies issuing variable annuity products will be retained by the Insurance Commissioner.

The benefit for Kansans is better investor protection. The Securities Commissioner has dealt with several cases in which a salesperson's securities license (to sell most products including mutual funds) has been suspended or revoked due to fraud or a serious violation. In one case, the sales agent then resorted to soliciting clients to "roll over" their mutual fund investments into variable annuities. In addition, there have been a number of media reports in recent years regarding sales practice problems.

It appears that 8 states may treat variable annuities as securities by statute or regulation with Kentucky being the most recent to change its laws in 1998. In addition, an insurance licensing guide shows that at least 14 states already require a sales agent to be licensed both by Securities and Insurance in order to sell variable annuities.

Testimony of

Carl B. Wilkerson, Chief Counsel, Securities  
of the American Council of Life Insurers

Before the Committee on Financial Institutions  
on House Bill No. 2690

February 8, 2000

The American Council of Life Insurers (the "Council") greatly appreciates the opportunity to share its views on House Bill No. 2690. Our 435 members represent 79.4 percent of all United States life and health insurance companies, 82.2 percent of the pension business, and 86.9 percent of the long term care insurance with such companies. 361 of our members are licensed to conduct life insurance in Kansas. Many of our members manufacture and distribute variable life insurance and variable annuities.

We oppose House Bill No. 2690. Two aspects of the bill are particularly troubling to life insurance companies:

House Bill No. 2690 would remove the Kansas Insurance Commissioner's sole and exclusive authority to regulate the issuance and sale of variable life insurance and variable annuities.<sup>1</sup>

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<sup>1</sup>House Bill No. 2690 would amend the variable contract law in the Kansas insurance code at 5. K.S.A. 40-436(l) as follows:

"The commissioner shall have ~~the sole and exclusive~~ jurisdiction and authority to regulate the issuance and sale of such contracts and to promulgate such reasonable rules and regulations as may be necessary to carry out the purposes and provisions of this act, and such contracts, the companies which issue them, and the agents or other persons who sell them, shall ~~not~~ also be subject to the provisions of article 12 of chapter 17 of the Kansas Statutes Annotated ~~not~~ and to the jurisdiction of the securities commissioner of this state."

House Bill No. 2690 would also subject variable life insurance and variable annuities to the Kansas Securities Code for the first time.<sup>2</sup>

### Summary of Position

Variable life insurance and variable annuities are one of the most heavily regulated financial products in today's broad marketplace.

HB 2690 would disrupt a coordinated system of state and federal regulation established by the U.S. Supreme Court.

The bill would cause duplicate regulation of the same product under the Kansas Insurance and Securities Codes.

HB 2690 would create expensive, unnecessary compliance burdens for life insurers and salespersons, and would discourage life insurers from distributing variable life insurance and variable annuities in Kansas.

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<sup>2</sup>The bill would amend the definition of "security" under the Kansas securities statute at K.S.A. 17-125(j) to provide that:

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

The bill would impose a fourth layer of regulation on variable life insurance and variable annuities on top of comprehensive SEC, NASD, and state insurance regulation.

The need for the amendment has not been justified. A pattern of abuse has not been identified.

HB 2690 creates an aberrant regulatory structure in Kansas that differs from almost every other state

### **Background**

Variable contracts are perhaps the most heavily regulated financial products in today's broad marketplace. The U.S. Supreme Court observed that variable contracts possess important characteristics of both insurance and securities, and ruled that their securities characteristics are subject to federal securities regulation, while their insurance characteristics are subject to state insurance regulation.<sup>3</sup> In the manufacture and distribution of variable contracts, therefore, life insurers satisfy multiple state and federal layers of regulation.

Variable contract separate accounts must be registered under the Investment Company Act of 1940, which is administered by the U.S. Securities and Exchange Commission. The disclosure appearing in variable contract prospectuses is reviewed and approved by the SEC.

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<sup>3</sup>*SEC v. Variable Annuity Life Insurance Company*, 359 U.S. 65 (1959); *SEC v. United Benefit Life Insurance Company*, 387 U.S. 202 (1967).



Advertisements must satisfy several detailed regulations under the federal securities laws, and must be filed with the SEC.

Variable contracts subject to the federal securities laws can only be sold by registered representatives of a broker-dealer that is a member of the National Association of Securities Dealers. The NASD's rules of conduct strictly govern the activity of securities salespersons, and impose detailed standards concerning advertising, supervision and the suitability of individual securities transactions. All advertisements used by NASD licensed salespersons must be filed with, and approved by, the NASD Advertising Department.

Activities of securities salespersons are also subject to SEC jurisdiction under the Securities Exchange Act of 1934. In addition to these specific standards, the federal securities laws impose broad antifraud proscriptions and give the SEC significant enforcement authority. Unlike other regulatory structures, the federal securities laws uniquely provide for private rights of actions by individual investors on certain core protections.

State insurance departments have comprehensive authority over life insurers and the products they issue. In addition to the variable contract statutes and regulations in most jurisdictions, variable life and variable annuities must also satisfy a broad array of requirements protecting the interests of consumers, such as unfair trade practices acts, illustration regulations, and advertising regulations. State insurance departments wield substantial authority over variable contracts in the issuance of variable contract certificates of authority, and in policy form

filing and approval. State insurance departments also continually evaluate insurers and their product distribution through very detailed market conduct examinations.

### **The Burdens of Conflicting State and Federal Standards**

Life insurers must satisfy multiple, comprehensive state and federal regulatory structures in developing and selling variable life and variable annuities. The financial services market in which variable contracts are distributed is extremely competitive and fast-moving. The delay and added expense caused by regulatory conflicts can significantly burden the marketability and competitiveness of variable contracts. Further, life insurers are untenably caught in an irreconcilable position when faced with inconsistent interpretations from a single insurance regulator that contradict the standards and interpretations of federal regulators and other state insurance departments.

### **Chronology From Design to Regulatory Approval**

The regulatory chronology insurers confront in bringing a variable contract to market may help illustrate the burdens of inconsistent regulation. After substantial investment in the design and mechanics of a variable life and variable annuity, actuaries price and identify the product to uniquely position it in the marketplace. Following this process, a life insurer must register a separate account funding the variable contract with the SEC under the federal securities laws. At this stage, SEC staff meticulously review the registration and its prospectus for completeness and

clarity, screening against material omissions or materially misleading statements. By this juncture, life insurers have invested substantial time and funds for accounting, legal and registration fees. With the product's approval under the federal securities laws, life insurers commit substantial resources to the systems supporting the product and its marketing. By the end of the SEC registration process, the identity and name of the variable annuity contract has been crystallized.

Following SEC approval, life insurers must have certificates of authority and policy form approval for the new variable contract from their domestic state and each state in which the variable contract will be marketed. Additionally, life insurers must fulfill comprehensive regulatory requirements in each state where they conduct business, based on standards patterned after NAIC model laws and regulations.

Kansas has enacted comprehensive laws and adopted regulations governing the manufacture and distribution of variable life insurance and variable annuities based on the NAIC model laws and regulations. These laws and regulations grant the insurance commissioner sole and exclusive jurisdiction to regulate these products, and follows the practice in almost every jurisdiction. This approach to regulation dovetails with the joint state and federal regulation of this product according to the standards established by the U.S. Supreme Court.

Salespersons distributing variable contracts must obtain an NASD license in order to sell these products, and must maintain rigorous continuing education standards. Supervising broker-

dealers enforce the NASD's rigorous rules of conduct, and fulfill significant supervision and suitability standards. Individuals committing felonies and dishonesty crimes are statutorily disqualified from being NASD licensed. Broker-dealers immediately must report salespersons terminated for cause on Form U-5, which is available on the NASD's publicly available computerized database, the CRD.

In sum, variable life and annuities pass meticulous scrutiny from design through approval.

### **Costs and Benefits of the Bill**

The need for the amendments has not been substantiated. No pattern of abuse has been cited. In our view, the desire for the amended statutes stems from a conceptual theory of expanded securities jurisdiction that is unfounded and incorrect. Adequate means already exist under the Kansas laws and regulations to police and prosecute market conduct matters. Subjecting variable life and annuities to the Kansas securities laws provides little regulatory value beyond that of the Kansas Insurance Commission, the SEC and the NASD. Duplicate, shared jurisdiction in Kansas over the same product will inevitably lead to expensive, untenable regulatory conflicts. The added cost of redundant regulation could deter the continued sale of variable contracts in Kansas. This consequence unnecessarily harms Kansas consumers by choking competition, and erects disincentives to conduct insurance and annuity business in Kansas. On balance, the economic burdens of the bill's amendments greatly overshadow its nebulous, unsubstantiated regulatory benefits.



## Conclusion

For the reasons stated above, the bill should be eliminated. We would be happy to address any questions, and greatly appreciate your time and attention to our views.



# KANSAS

Bill Graves  
Governor

OFFICE OF THE SECURITIES COMMISSIONER

David Brant  
Commissioner

TESTIMONY IN SUPPORT OF HOUSE BILL No. 2243  
Amendments to the Kansas Securities Act  
Financial Institutions Committee Kansas House

DAVID BRANT  
Kansas Securities Commissioner  
February 12, 2001

Mr. Chairman and members of the committee, thank you for this opportunity to testify in support of House Bill No. 2243 which proposes a number of amendments to the Kansas Securities Act.

We have just reviewed a summary and explanation of the majority of the proposed amendments. I would now like to address the provisions of the bill which propose to amend the definition of "securities" to include variable products. My testimony also includes the attachments which include and explanation and a number of letters of support.

A variable annuity is a hybrid product involving both investment and insurance components which is typically marketed as a tax-deferred way to invest in mutual funds for retirement. A variable annuity is an insurance contract which provides for future payments, the amount of those payments depends on the performance of the underlying investments.

I am not here to criticize the variable annuity product or the insurance industry or its agents. You should know that (thanks to the Governor and the Legislature) a sizeable portion of my retirement savings is invested in a number of mutual funds through an Aetna variable annuity contract which is offered through the state's deferred compensation benefit plan.

I believe that the merits of the variable products provisions can best be analyzed by considering the following questions:

1. **Is it unreasonable to treat this hybrid insurance/investment product the same under both state and federal law?**

The U.S. Supreme Court has opined and confirmed that variable insurance products are securities and are subject to regulation by the U.S. Securities and Exchange Commission (SEC). At the state level, the original version of the Uniform Securities Act adopted by Kansas in 1956 did not exclude variable annuities as securities. However, the Kansas law was amended in 1968, as it was in many states, to exclude variable annuities from the definition of securities and to grant exclusive jurisdiction to the Insurance Commissioner.

It appears that the trend is for states to treat variable annuities as securities with Kentucky being the most recent to change its laws in 1998. Regardless of state law treatment, a New York insurance company has provided their internal checklist which shows that they require their agents to obtain state securities licenses (in addition to the insurance license) in at least 14 states in order to sell variable annuities.

**2. Does our current law promote a “level playing field” for the regulation of variable products in the new era of financial modernization and functional regulation?**

“Financial modernization” is becoming a reality due to the federal law changes contained in the Gramm-Leach-Bliley Act of 1999. Congress passed the Act to modernize the delivery of financial services by removing depression-era barriers that separate banking, securities, and insurance functions. The new federal act provides for “functional regulation” of financial entities and their products – banks by banking regulators, securities affiliates by the SEC and state securities regulators; and insurance companies by state insurance regulators. For a hybrid product such as variable annuities, functional regulation requires split jurisdiction between securities and insurance at the state level – just as it exists at the federal level.

**3. Does this proposed legislation add a burden or place an additional cost on insurance companies or their agents?**

In proposing this bill, my purpose is not to impose any additional regulatory burden or cost on the insurance companies that package the products or on the agents who sell variable annuities. Attached is a chart which outlines the various requirements for variable annuities and the licensing requirements for agents.

Many agents currently hold both securities and insurance licenses so that they can offer a variety of investment and insurance products, including variable annuities, to their customers. These agents are proof that financial modernization and “one-stop shopping” have already arrived. I assert that the majority of Kansas insurance agents (and the numbers increase every month) already have both licenses so that they can also sell mutual funds. Thus, the change in the definition of “securities” proposed by the bill will not require any additional paperwork, nor cost these agents any additional fees. For the few agents that would need to obtain the securities license, the annual fee is \$50.

The agents are required to be affiliated with a Broker-Dealer firm which is usually a subsidiary or an affiliate of an insurance company which is required to be registered with the National Association of Securities Dealers (NASD). It is only these Broker-Dealer firms, and not the insurance companies, that need to be registered and many of these firms are already registered with the Kansas Securities Commissioner in order to sell mutual funds in addition to variable annuities. Thus, the bill will not require any additional paperwork or fees for the firms that are already registered. There may be some out-of-state Broker-Dealers that will need to register and pay an annual fee of \$200.

The variable annuity product will continue to be exempt from registration with the Securities Commissioner as provided in K.S.A. 17-1261 which is amended in Section 2 of the bill. The product is registered with the SEC (since the product is a federal covered security) and it is qualified by the Insurance Commissioner. None of this will change.

Neither do we anticipate any fiscal impact on our agency at this time. There should be no minimal effect on the revenues to the Securities Act Fee Fund since most of the broker dealers and agents that sell variable annuities are already licensed to sell securities as previously noted. If the bill is enacted, there would be additional responsibility and some work for the agency. However, we do not anticipate a need and we will not be asking for any additional budget authority for staff or other expenses at this time.

#### 4. Does House Bill 2243 enhance investor protection for Kansas consumers?

The benefit for Kansans who invest in variable products is better investor protection. Not only does this bill “level the playing field” regarding the regulation of variable products, but the most important purpose of this proposal is to provide for effective enforcement remedies in the rare occasion when there is a problem. Why should we encourage our citizens to contact the Securities Commissioner if they have a problem with an agent who sold them mutual funds... but send them to another agency when the problem involves an agent who sold them mutual funds wrapped inside a variable annuity?

We continue to see a number of cases which cause me concern about the current disjointed regulation of variable products. These cases involve serious violations which have resulted, or could result, in a felony conviction or the revocation of a securities license. In fact, in one case, we revoked the securities license of a salesperson, only to receive calls from his customers who were solicited by the salesman to “roll over” their mutual funds into a variable annuity (to be invested in mutual funds) since the agent could still purportedly sell annuities with his insurance license.

As the Securities Commissioner, I am not motivated by regulatory turf or by revenues. Let me clarify that we are not proposing “an additional layer” or “duplicative” regulation. I believe that the bill proposes a reasonable “hybrid” approach of functional regulation in regard to these “hybrid” variable products. It may be suggested that the Kansas Securities Commissioner is not needed since the industry’s regulator, the National Association of Securities Dealers (NASD), has taken a number of actions regarding variable products in recent years. Kansas Securities shares jurisdiction with the NASD over the agents who sell mutual funds – why shouldn’t we share jurisdiction over the agents who sell mutual funds wrapped in a variable annuity contract?

In conclusion, please review the four questions outlined above. This bill does not promote bigger government or unnecessary regulation. This bill will not add significant regulatory paperwork, fees, or licenses. Most annuity firms and the agents selling variable products will only be affected by this bill – if there is a problem. And if there is a problem in the year 2001, Kansas investors deserve a regulatory structure that is reasonable and that makes good common sense – not a structure that was devised in 1968, some 33 years ago. Times have changed – financial modernization is here.

Thank you for your consideration.

#### Attachments

Summary and Explanations of House Bill 2243

Explanation of Exhibits

Exhibits



## **HOUSE BILL No. 2243**

### **Explanation of Exhibits**

**David Brant**  
**Securities Commissioner**

#### Outline of Product and Agent Requirements

This outline shows a comparison of variable annuities and mutual funds and the requirements for agents. The table also estimates that 8 states already consider variable annuities as securities and that at least 14 states require agents to have a state securities license to sell variable products.

#### Outline of Functional State Regulation

This outline shows that the bill's provisions will not change functional regulation as it currently operates. For example, insurance companies such as Security Benefit Life Insurance continue to be solely regulated by the Insurance Commissioner. The amendment to the Insurance Code on page 25, line 40, retains exclusive jurisdiction of the Insurance Commissioner over variable products and insurance companies. Security Benefit's broker-dealer who sells the variable products is Securities Distributors, Inc. and they are already registered with and regulated by the Securities Commissioner. House Bill 2243 would fix the current contradiction in functional regulation under current law and allow the Securities Commissioner to now handle a sales complaints about a variable product, which has to be sold through a broker-dealer, which in this example is already registered to sell securities in Kansas.

E-mail from Joel Seligman, Dean  
Washington University School of Law  
Reporter for the NCCUSL Drafting Committee

The new millennium is the time for financial modernization and uniform and streamlined regulation at both the federal and state level. The financial services industry wants uniform and streamlined regulation across the fifty states. A "blue ribbon" panel of securities lawyers is currently working on a new draft of the Uniform Securities Act for the National Conference of Commissioners on Uniform State Laws (NCCUSL) which could be considered for adoption by NCCUSL members as early as this August.

The Reporter for the NCCUSL Committee is Joel Seligman, Dean of the Washington University School of Law, and one of the leading securities law experts. The committee met last September with Mr. Carl Wilkerson of the American Council of Life Insurers. Mr. Wilkerson made his case, as he did last year and as he will again today, that it is unnecessary to define variable products as securities. As you can see from the highlighted excerpt in Dean Seligman's message, the NCCUSL committee believes it is "wiser" to include variable products under state securities laws.

The NCCUSL draft would add the same amendment to insert the words "a fixed sum of" to clarify the exclusion as is proposed on page 3, line 6.

Copied on the back of the message is a list of the members of the NCCUSL committee which includes a number of securities lawyers and one Republican lawmaker from Michigan. You will note that this

committee is not comprised of state regulators or bureaucrats... and yet this committee apparently wasn't persuaded by ACLI's arguments that this would amount to unnecessary additional regulation.

Letter from Richard Hite, Wichita Attorney  
NCCUSL Commissioner for Kansas

Dean Seligman's message is endorsed by a letter from a Kansas member of NCCUSL, Richard Hite, an attorney from Wichita.

Letter from Fred Lovitch, Professor  
University of Kansas School of Law

And lastly from another legal expert, attached is a letter from Fred Lovitch, a long-time professor at the University of Kansas Law School who teaches securities law.

#### Recent News Headlines about Variable Annuities

It will be suggested to you today that there is no crisis in Kansas with variable products. While I agree that there may not be a crisis, my approach has been to be proactive in following the trend with agents selling a variety of products in today's marketplace. The headlines in recent years suggest that the SEC and the NASD are concerned about the explosive growth in the sale of variable products and the indications of some abuses in sales practices.

#### SEC Case Alleging Variable Switching (9/25/00)

Another new development since last year is that the SEC brought its first case dealing with switching variable annuities against a Florida investment adviser last fall. The SEC alleges that the adviser fraudulently induced his clients to switch variable annuities generating unnecessary sales charges of \$168,000. I would allege that if this case were to happen in Kansas, that the best functional regulator to handle the complaint would be the Securities Commissioner since we have experience in handling mutual fund switches and churning.

Further, an SEC spokesman has been quoted as saying that variable annuities are growing in popularity with financial services firms because the fees and commissions they generate are higher than those of mutual funds.

The other troubling concern of this Florida case is that it involved an investment adviser. The state securities commissioner is the sole regulator of investment advisers and financial planners managing less than \$25 million (they are not regulated by the SEC or NASD). Arguably, the Securities Commissioner may be prohibited against bringing a similar case, if it happened in Kansas, since we can only deal with an adviser's handling of advice about securities which would exclude variable products under current law.

#### Article on Bonus Annuities (*Forbes* 2/19/01)

Attached is a just published article which raises concerns about the sale of bonus annuities and cites the example of how a couple was misled.

Letter from Mary Schapiro, President  
NASD Regulation, Inc.

I expect that Mr. Wilkerson will show you tables and statistics to show that the number of NASD complaints and actions regarding variable products is on the decline... to imply that any concerns are going away or are being adequately addressed. To the contrary, the SEC and the NASD appear to be increasing their scrutiny of variable sales. In addition, I believe that Mr. Wilkerson may have implied last year that state securities regulation was not needed since the NASD and state insurance commissioners had authority. Attached for your consideration is a letter from the President of NASD Regulation, Mary Schapiro, in which she endorses the bill since it promotes functional regulation. I would think that the NASD would not take this position if they believed that state securities regulation would be redundant or unnecessary.

Letter from Jack Rosenfield, Former District Director  
Kansas City office of NASD Regulation, Inc.

Since Jack Rosenfield was the NASD's District Director in Kansas City for 18 years, his letter provides a regional perspective to complement the previous letter from the NASD President. Mr. Rosenfield suggests that it would be more cost-effective and efficient for the Securities Commissioner to regulate the sale of variable products, since they are packaged securities products. Further, he believes passage of the bill will further the public interest and advance investor protection.

Letter from Betsy Rohleder of Securities America  
Kansas Agent licensed both with Insurance and Securities

Betsy Rohleder is both a Kansas insurance agent and a securities representative. She writes that she supports the functional regulation of the Insurance Commissioner regulating insurance sales and the Securities Commissioner regulating securities sales. "We should not be fearful of having our work overseen or regulated by the appropriate agencies...I believe it strengthens our industry and better protects our customers,"

Letter from Jim Reardon, Certified Financial Planner  
Kansas Agent licensed both with Insurance and Securities

Jim Reardon is a Certified Financial Planner who is licensed to provide investment advice and licensed to sell both insurance and securities. His letter supports the bill since variable products are sold as investments to customers.

SEC Investor Pamphlet on Variable Annuities

Attached is the SEC's informational pamphlet describing variable annuities and what questions that investors should consider.

Reasons to Support Amendments for Variable Products

This outline summarizes four reasons to support the inclusion of variable products as securities: 1) uniformity with federal law and the proposed Uniform Securities Act; 2) variable products are sold as investments; 3) there will be no additional cost or burden on most agents and the industry; and 4) there is no regulator of state-registered financial planners and investment advisers regarding variable products.

## House Bill 2243

<b>Product</b>	<b>Purpose</b>	<b>Considered a Security</b>			<b>Offered through Broker-Dealer</b>	<b>Registration/Qualification</b>		
		<b>Federal</b>	<b>Other States</b>	<b>Kansas</b>		<b>SEC</b>	<b>KS Securities</b>	<b>KS Insurance</b>
<b>Mutual Funds</b>	<b>Investment</b>	Yes	All	Yes	Yes	Notice Filing (covered security)	NA	
<b>Variable Annuities</b> (with mutual fund options)	<b>Investment and Insurance</b>	Yes	8	<i>No*</i>	Yes	Exempt (covered security)	Yes	

<b>Agent</b>	<b>Affiliated with a Broker-Dealer</b>	<b>Licenses Required</b>				<b>Exams Required by Kansas</b>	
		<b>National Assoc. Securities Dealers</b>	<b>Other State Securities</b>	<b>KS Securities</b>	<b>KS Insurance</b>	<b>NASD</b>	<b>Blue Sky and Ethics</b>
<b>Mutual Funds</b>	Yes	Yes	All	Yes	NA	Series 6	Series 63
<b>Variable Annuities</b> (with mutual fund options)	Yes	Yes	14+ <sup>⊖</sup>	<i>No*</i>	Yes	Series 6	<i>None*</i>

\* Will change if House Bill 2243 is enacted.

⊖ Arizona, Florida, Idaho, Kentucky, Minnesota, Montana, Nevada, North Dakota, Rhode Island, South Dakota, Utah, Vermont, Washington, Wyoming and Puerto Rico.



## Functional State Regulation

# Insurance

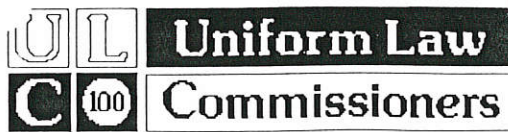
Aetna Life Insurance and Annuity Company  
Security Benefit Life Insurance Company

	<i>Before House Bill 2243</i>	<i>After House Bill 2243</i>
State Registration	Insurance Company	Insurance Company
State Regulator	Insurance Commissioner	Insurance Commissioner
Type of Filing	NAIC	NAIC
Annual Fee	\$110	\$110
Products subject to regulation	All insurance and variable products	All insurance and variable products
Agent licensing and sales practices	Sales of insurance	Sales of insurance

# Securities

Aetna Investment Services  
Securities Distributors, Inc.

	<i>Before House Bill 2243</i>	<i>After House Bill 2243</i>
	Broker-Dealer	Broker-Dealer
	Securities Commissioner	Securities Commissioner
	CRD (electronic)	CRD (electronic)
	\$200	\$200
	Preempted from product regulation of "covered securities" including mutual funds and variable products	
	Sales of securities <u>except</u> variable products	Sales of securities <u>including</u> variable products



# The National Conference of Commissioners on Uniform State Laws

## Drafts of Uniform and Model Acts

**From:** "Joel Seligman" <Seligman@wulaw.wustl.edu>  
**To:** <Dbrant@cjnetworks.com>  
**Cc:** <craig.goettsch@comm6.state.ia.us>; "Joel Seligman"  
<Seligman.MUDD.WULAW@wulaw.wustl.edu>  
**Sent:** Wednesday, January 10, 2001 2:09 PM  
**Subject:** Variable Products  
David:

At a recent meeting of the NCCUSL Drafting Committee to update the Uniform Securities Act, Carl Wilkerson of the ACLI asked the Drafting Committee to exclude variable products from the definition of security. The Drafting Committee discussed this and tentatively concluded that it would be wiser to include variable products in the definition of security so that they could be reached under the fraud and liability provisions and under the broker-dealer and other sales practices provisions.

Separately, insurance company securities, including variable products, are exempted.

We were aware that NSMIA further as a practical matter has transformed many variable products into federal covered securities and that the potential scope of the Uniform Securities Act is considerably reduced because of NSMIA.

Finally I should emphasize that this tentative approval will be revisited by the Drafting Committee before final approval.

Sincerely,

Joel Seligman

(Joel Seligman is the Dean of the Washington University School of Law)

### **Drafting Committee to Revise Uniform SECURITIES ACTS**

#### Uniform Securities Acts

- Smith, Richard B., *Chair*
- Arnold, John Fox
- Kittleson, Henry M.
- Lisman, Carl H.
- Richner, Andrew
- Sullivan, Michael P.
- Swibel, Howard J.
- Vigdor, Justin L.
- Tennessen, Robert J., *Division Chair*
- Baden, Alan P., *American Bar Association Advisor*
- Seligman, Joel, *Reporter*

## NCCUSL Drafting Committee – USA

Richard B. Smith, Chair  
Davis, Polk & Wardwell  
New York, New York

Howard T. Rosen  
Millburn, New Jersey

Henry Kittleson, Division Chair  
Holland & Knight, LLP  
Lakeland, Florida

Michael (Mike) Sullivan  
Minneapolis, Minnesota

John Fox Arnold  
Lashly & Baer, P.C.  
St. Louis, Missouri

Justin L. Vigdor  
Boylan, Brown, Code, Vigdor & Wilson, LLP  
Rochester, New York

Carl H. Lisman  
Lisman, Webster, Kirkpatrick, Leckerling, P.C.  
Burlington, Vermont

Brent W. Wright  
Wright & Wright  
Tulsa, Oklahoma

Representative Andrew (Andy) Richner  
Lansing, Michigan

## Uniform State Laws, Advisory Committee on

(K.S.A. 46-407a)

James M. Concannon, Commissioner, 1700 College, Topeka 66621  
Richard C. Hite, Commissioner, 200 W. Douglas, Wichita 67202  
Elwaine F. Pomeroy, Commissioner, 1619 Jewell, Topeka 66604

### **Associate Commissioner ex officio:**

John F. Hayes, P.O. Box 2977, Hutchinson 67504  
Glee S. Smith, P.O. Box 360, Larned 67550  
Paul L. Wilbert, National Bank Building, Pittsburg 67762 (deceased)

### **Ex officio Members:**

Sen. Tim Emert, Chairman, Senate Judiciary Committee  
Rep. Mike O'Neal, Chairman, House Judiciary Committee

RICHARD C. HITE  
RICHARD L. HONEYMAN  
RANDY J. TROUTT  
ARTHUR S. CHALMERS  
KIM R. MARTENS  
LINDA S. PARKS  
F. JAMES ROBINSON, JR.  
DON D. GRIBBLE, II  
DENNIS V. LACEY  
LISA A. MCPHERSON

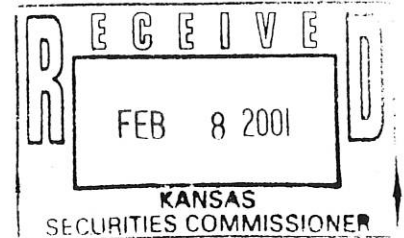
**H/H**  
HITE  
FANNING &  
HONEYMAN L.L.P.  
ATTORNEYS AT LAW

JERRY D. HAWK  
JON E. NEWMAN  
SCOTT R. SCHILLINGS  
RICHARD D. CROWDER

OF COUNSEL  
H.W. FANNING  
VINCE P. WHEELER

February 7, 2001

David Brandt, Commissioner  
Office of the Securities Commissioner  
618 South Kansas Avenue  
Topeka, KS 66603-3804



Re: House Bill No. 2243

Dear Commissioner Brandt:

Thank you very much for your letter of February 5 regarding H.B. No. 2243.

It is my strong belief that the Uniform Securities Act now under consideration by the National Conference of Commissioners on Uniform State Laws and the amendments to the Kansas Securities Act should be consistent with existing federal law. I also strongly believe that the definition of security should include variable annuities to be consistent with the decision of the United States Supreme Court and to ensure that they receive appropriate regulatory oversight.

It is anticipated that the National Conference of Commissioners on Uniform State Laws will give final approval to the revised Uniform Securities Act at its annual meeting in August. Thereafter, there will be concerted effort to have the Uniform Act adopted by all states. It has been past experience that, even if the Uniform Act is not adopted in its entirety by a given state, the act still has substantial influence on similar legislation. Assuming that this past experience is a predictor of what the future may hold, I believe it would be disadvantageous for the State of Kansas and for the insurance industry if Kansas legislation was not consistent with that of other states.

Thank you for giving me an opportunity to comment about the proposed legislation.

**H/H**

Sincerely yours,

A handwritten signature in black ink, appearing to read "Richard C. Hite". The signature is written in a cursive style with a large initial "R" and a long horizontal stroke at the end.

Richard C. Hite  
HITE, FANNING & HONEYMAN L.L.P.

plc

cc: Elwaine Pomeroy



# The University of Kansas

School of Law

February 6, 2001

Representative Ray Cox, Chairman  
House Financial Institutions Committee  
State Capitol  
Topeka, Kansas 66612

Dear Chairman Cox:

I have been a full-time member of the faculty of the University of Kansas School of Law since 1972, during which time I have taught Securities Regulation Law each year. I have also served on the Advisory Council to the Kansas Securities Commissioner for over 16 years.

Several years ago, a group of law students assisted me in drafting a report on variable annuities. We reviewed both federal and state laws and cases. The U.S. Supreme Court has ruled that variable annuities are securities.

I personally believe that it is time that our state definition of "security" follow federal law and the proposed wording for the new Uniform Securities Act as drafted by the NCCUSL committee.

Thus, I strongly support House Bill No. 2243.

Thank you for your consideration of this legislation, which would promote uniformity and functional regulation.

Sincerely,



Fred Lovitch  
Professor of Law

## Variable Contracts

The NASD Reminds  
Members Of Their  
Responsibilities  
Regarding The Sale Of  
Variable Life Insurance

NEWS AND ANALYSIS FOR REGULATORY AND COMPLIANCE PROFESSIONALS

NOVEMBER 2000

VOL. 15, NO.11

## SEC Director Comments on Variable Insurance Products

**SEC Charges Florida Man  
With Fraud Against Advisory Clients**

SEC BRINGS FIRST VARIABLE ANNUITY  
SWITCHING ACTION.

THE WALL STREET JOURNAL TUESDAY, JANUARY 25, 2000

## 'Bonus' Annuities Attract SEC Scrutiny

*Variable annuities are more  
hassle than they are worth*

Forbes ■ February 9, 1998

# The great annuity rip-off

### Insurance

BY RUSS WILES

## Variable Confusion

Variable annuities are among the most complicated mass-market investments around. Here's an overview of what the products offer, and what they cost.

*SEC Steps Up Probe  
Of Annuity Sales  
By Insurance Firms*

THE WALL STREET JOURNAL FRIDAY, OCTOBER 24, 1997

*Some Variable-Annuity Sales Practices  
Worry Regulators at SEC, Aide Says*

THE WALL STREET JOURNAL MONDAY, JUNE 30, 1997

*For Older Investors, Allure of  
Variable Annuities Belies Pitfalls*

**IA** WEEK

Commission to Analyze Annuity Switches

**NASD  
Notice to  
Members  
99-35**

The NASD Reminds  
Members Of Their  
Responsibilities  
Regarding The Sales Of  
Variable Annuities

### *Investment Advisers*

## **SEC Charges Florida Man With Fraud Against Advisory Clients**

**T**he Securities and Exchange Commission Sept. 25 charged Orlando, Fla., resident Raymond A. Parkins Jr., the former president of an investment advisory firm and broker-dealer, with fraudulently inducing clients to effect switches in their investments (*In re Parkins*, SEC, Admin. Proc. File No. 3-10300, 9/25/00).

In particular, the SEC brought charges in an administrative and cease-and-desist complaint against Parkins, who was formerly the president of Parkins Investment Advisory Corp. (Parkins Advisory) and Parkins Investment Securities Corp. (Parkins Securities), both formerly registered with the SEC.

The SEC alleged that from at least 1993 through 1996, Parkins, on at least 24 occasions, induced his investment advisory clients to switch their variable annuity investments by providing them with unfounded, false, and misleading justifications for the switches, including false and misleading comparisons of the performances of certain variable annuities and false assurances that the switches would increase the diversification of his clients' portfolios.

The SEC further alleged that Parkins sent switch recommendation letters to his clients that misrepresented or failed to inform them of the sales charges associated with the switches.

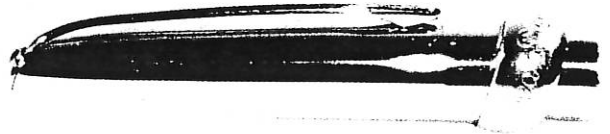
As a result of Parkins' alleged fraudulent conduct, the SEC alleged that his clients incurred unnecessary sales charges of more than \$168,000, and, in some cases, lost a portion of their investment principal, and that Parkins Securities received commissions of more than \$210,000.

The SEC further alleged that Parkins aided and abetted and caused Parkins Advisory's violations of certain federal securities law antifraud provisions specifically pertaining to investment advisers. He also allegedly aided and abetted and caused Parkins Advisory to fail to make and keep true, accurate and current, as required, certain records relating to Parkins Advisory's dealings with its clients.

Parkins is not currently represented by counsel, according to an SEC attorney who worked on the case. Parkins could not be reached for comment.

A hearing will be scheduled to determine whether the staff's allegations are true, and if so, whether remedial sanctions and penalties should be imposed against Parkins.

# Annuity Gratuity



Trade-in bonuses for variable annuities sound good. They really aren't. That's why the SEC is looking at them hard.

BY CARRIE COOLIDGE

**W**E SAID IT THREE YEARS ago in a cover story (*Feb. 9, 1998*) and we'll say it again at the outset here:

Most variable annuities are very bad investments. These creatures are mutual-fund-like accounts with the patina of an insurance policy that has the effect of deferring taxes on investment earnings. Fees are high and the tax advantage is often an illusion, since the annuity converts low-taxed capital gains into higher-taxed ordinary income.

Now let's look at a new variation on this old game, the bonus annuity. To get you to sign up—and to transfer assets from an existing annuity—silver-tongued sales reps are offering a bounty of between 3% and 10% of your transferred investment.

There are plenty of catches with the new annuities, though: higher fees and longer surrender periods (ten years is typical). Surrender fees from the old account whittle down your bonus. Although the variable annuity associations do not

publish the numbers, it is estimated that half the bonus accounts sold are transfers from annuities that haven't yet hit the seven-year mark when surrender fees vanish.

Look at the plight of a retired couple in Potomac, Md. who listened to their certified financial planner and surrendered an annuity they had bought from him four years earlier. The enticement: If the couple transferred the \$1 million from the old annuity to a new one offered by insurer ING Golden American, they would get a \$50,000 bonus to juice their new account.

The couple's financial planner assured them the bonus would amply cover the \$25,200 surrender charge from the old annuity (4% of their original investment of \$630,000). "He bragged they would make a profit of \$24,800 the minute they signed on the

dotted line," says J.J. MacNab, a Bethesda, Md. insurance analyst who is now advising them. "He had been managing all their money for the past five years. They trusted him."

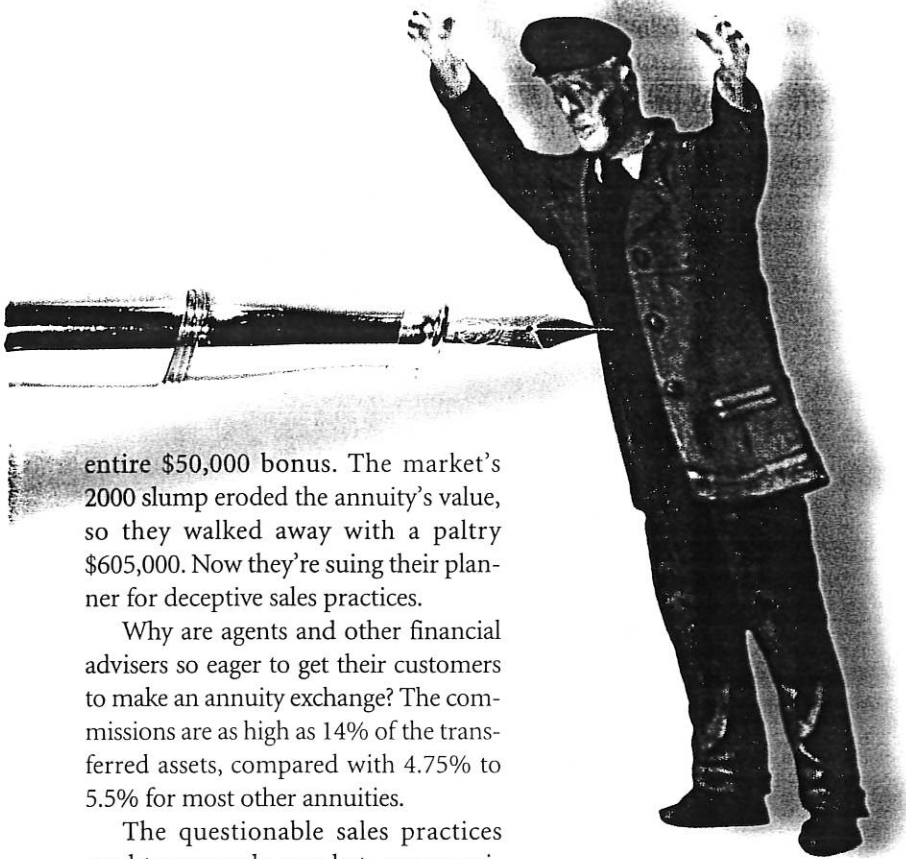
The couple is hardly naive about investments: They owned apartment buildings around Washington, D.C. before turning the business over to their son and were well fixed enough to put off withdrawing from the annuity account. Yet they didn't realize until too late the ING Golden American annuity's negative features. The annual expense was 1.7%, compared with 1.25% on the old account, and the surrender charge, which started out at an exorbitant 8%, would take nine years to go away. If the couple had kept their original annuity for three more years, they could have surrendered it with no penalty.

Sadly, the husband then was diagnosed with terminal cancer and he needed cash for estate tax purposes and medical expenses. But getting out meant paying a surrender fee of \$80,000 plus reimbursing the insurer the

**ONE COUPLE SAW THEIR EXPENSE  
RATE JACKED UP FROM 1.25%  
TO 1.7% ANNUALLY.**

DENNIS GALANTE FOR FORBES





entire \$50,000 bonus. The market's 2000 slump eroded the annuity's value, so they walked away with a paltry \$605,000. Now they're suing their planner for deceptive sales practices.

Why are agents and other financial advisers so eager to get their customers to make an annuity exchange? The commissions are as high as 14% of the transferred assets, compared with 4.75% to 5.5% for most other annuities.

The questionable sales practices used to persuade people to swap variable annuities, both the bonus and the nonbonus kinds, have attracted notice from the SEC and the National Association of Securities Dealers. The SEC is examining marketing materials produced by the biggest underwriters, including ING Golden American, American Skandia and Allianz Life. "The industry is on notice," says Paul Royce, director of the SEC's Division of Investment Management.

The SEC in September filed its first cease-and-desist proceeding over annuity sales. In its complaint the SEC alleges that Raymond A. Parkins Jr., an investment adviser in Orlando, Fla., didn't bother to tell clients about the "unnecessary" sales charges he raked in, totaling \$210,000 for himself and his firm. Parkins, in a letter to the SEC, says he didn't mislead or harm his clients. A hearing is scheduled for May 21.

American Skandia's chief executive, Wade Dokken, dismisses criticism of bonus annuities as ginned up by rivals

who don't offer the product. "The bonus is always better," he says.

Always? Let's compare returns from a bonus product called USAllianz Rewards and a regular variable annuity called Nationwide Multi-Flex VA. Say that both start off with a \$10,000 investment and have an annualized investment return of 10%. The Allianz buyer has his head start: Add in the 4% bonus he gets and he suddenly has \$10,400 (if he didn't switch from another annuity that whacked him with a surrender fee).

But Allianz charges 1.65% in fees annually and Nationwide 1.3%. After ten years the two accounts are almost the same. By the 15th year Nationwide has opened up a lead, \$34,950 versus \$34,631 for Allianz. Just as bad is that Allianz's surrender period is ten years and charges start at 8.5%; Nationwide's: seven years, 7%.

Our advice: When in doubt, don't buy any annuity. **F**

# Footnote Investor

Robert Olstein never visits companies in which he's invested. He can't even name the executives who run them. So why is his mutual fund so successful?

BY BERNARD CONDON

IT IS AN HOUR AND A HALF INTO THE trading day, and American Home Products is down 10%. A Bear Stearns analyst just downgraded the drugmaker, figuring Alan Greenspan's interest rate cut means investors should move into faster-growth stocks. Robert Olstein has put \$4 million into the company this morning and is telling a trader standing before him to keep buying.

"What do interest rates have to do with the demand for drugs?" he fumes. "An analyst says move out of the industry, and all the sheep fly from the stock."

"Sheep" is a mild rebuke coming from this 59-year-old contrarian investor. As Olstein places his bets, "moron," "lunatic" and "stupid" trip off his tongue. The fiery personality doesn't seem to have hurt his performance. His mutual fund, Olstein Financial Alert, is up an average annual 24% since he opened it in 1995. He made 13% in 2000, a year when an equity fund was lucky to break even.

One of Olstein's secrets: Don't interview management. "Why should I talk to the ministers of propaganda?" he says. "I want to see what people do, not what they say." Instead, he says, look at the financial statements, especially footnotes. Two years ago he bailed out of Lucent Technologies when he spotted it dipping into reserves to goose earnings, and 11 other worrisome accounting signs. The stock nearly doubled to \$84. Then management lowered earnings four times. It now trades at \$18.



Mary L. Schapiro  
President

Via Federal Express

February 8, 2001

The Honorable Ray Cox  
Chairman  
House Financial Institutions Committee  
Kansas Legislature  
State Capitol  
Topeka, Kansas 66612

Dear Mr. Chairman:

I am writing in regard to House Bill No. 2243, which would amend the Kansas Securities Act to include variable annuities and variable life insurance products within its coverage.

NASD Regulation is the regulatory arm of the National Association of Securities Dealers. Established under authority granted by the Securities Exchange Act of 1934, NASD is the largest self-regulatory organization for the securities industry in the world. Every broker/dealer in the U.S. that conducts a securities business with the public is required by law to be a member of the NASD. The NASD's membership comprises almost 5,600 securities firms that employ more than 670,000 registered securities professionals.

As you know, variable contracts are hybrid products that combine securities and insurance components. Because of their insurance components, we agree that the Kansas Insurance Commission should retain jurisdiction over variable contracts, and we understand that this bill provides exclusive jurisdiction over the insurance companies issuing variable annuity products will be retained by the Insurance Commissioner. However, our experience in regulating our members' sales of variable contracts leads us also to strongly support the bill because it provides functional regulation by your securities commission over the sales practices and licensing of agents involved in the sale of variable annuities.

Sales of variable contracts have grown enormously over the past ten years. NASD Regulation has found through its examination of member broker/dealers that frequently these products are promoted on many of the same grounds as other securities products. Broker/dealers recommend variable annuities and variable life insurance policies as vehicles to save for retirement, just as mutual funds and other non-insurance securities are recommended as retirement vehicles. In many cases broker/dealers recommend variable products over other securities because of their perceived advantages, particularly the potential for tax-deferred growth of a customer's investment. Like other securities, variable

The Honorable Ray Cox  
February 8, 2001  
Page 2

products present investment risks because of the fluctuation of underlying sub-accounts in which customers' funds are invested. Given the increasing prominence of variable products, NASD Regulation has stepped up its efforts in this area through focused examinations, guidance to our members and enforcement actions.<sup>1</sup>

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

If you have any questions regarding our position or the operations of NASD Regulation, please do not hesitate to contact me, at (202) 728-8140, or Tom Selman, Senior Vice President, Investment Companies/Corporate Financing, at (240) 386-4533.

Sincerely,



Mary L. Schapiro  
President

cc: Tom Selman

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<sup>1</sup> For more information please see [www.nasdr.com](http://www.nasdr.com), which contains the following relevant information: *Notice to Members* 96-86, 99-35 and 00-44, the *Regulatory and Compliance Alert*, Summer 2000 at 12, and our press release of July 8, 1999 (Pruco Securities fined \$20 million).



11215 Grandview Street  
Overland Park, KS 66210

February 6, 2001

Representative Ray Cox  
Chairman, House Financial Institutions Committee  
State Capitol  
Topeka, KS 66612

Re: House Bill No. 2243

Dear Representative Cox:

I write in support of House Bill No. 2243 as a means of allowing the state of Kansas and, specifically, the Office of the Securities Commissioner ("Securities Commissioner"), to more effectively and efficiently pursue its legislative mandate to embrace the public interest and further the protection of investors. Although I am presently employed in the securities industry my comments represent solely my own thoughts and convictions as a former securities industry regulator, and not necessarily those of my employer.

For background purposes, I retired in May 2000 from the National Association of Securities Dealers and NASD Regulation (collectively referred to hereafter as "NASD") after 30 years of service in a number of capacities beginning as a securities investigator. My most recent position and one held for more than 18 years was that of District Director of the NASD regional office in Kansas City, MO. In my capacity as Vice President and District Director of that office I had responsibility for overseeing the securities activities of approximately 300 securities broker-dealers and over 6000 branch offices in a seven state area, including those in the state of Kansas.

During the more than 18 years in which I directed our investigations and disciplinary actions involving the securities activities of our member firms within the seven state region, I had the opportunity to work jointly with the Securities Commissioner on several occasions. However, our presence in that regard should not be misinterpreted by anyone to conclude that the NASD office was functioning in an adjunct or supplemental capacity to that of the Securities Commissioner. Any joint, investigative programs were routinely done in the interest of taking a cost-effective approach to a common problem in the face of limited resources. In that regard, NASD's jurisdiction is limited to its member firms and their associated persons. The Securities Commissioner's authority is much broader within the state and that is as it should be. To argue that the NASD already exists as proxy regulator for the Securities Commissioner would be a blatantly false and misleading position to assume.

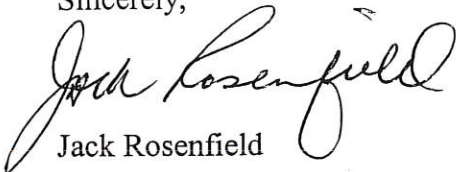
While I certainly can't speak on behalf of the NASD today, during my tenure we were never in a position, resource or otherwise, to assume jurisdiction over what were considered "state matters", and had no desire or inclination to do so. **To proffer as some have, I believe, that the proposed legislation would create a redundancy of regulation does not comport with the functional distinctions between our two offices and how we sought to carryout our respective mandates.** Defining variable annuity products as "securities" in the state of Kansas should have no impact on the NASD regional office or its relationship with the Securities Commissioner, in my opinion. **The real impact would be to assure the residents of Kansas that they were receiving a valuable investor protection initiative from their Securities Commissioner.**

Kansas, having excluded variable annuity products from the definition of "securities", has, in my opinion, **fostered an unfortunate lapse in investor protection** in strong contrast to a position authored by the SEC, upheld by the courts and in existence for more than three decades. **It makes for a very pronounced contradiction in the eyes of Kansas' investors** who otherwise comfortably seek the protection and counsel of the Securities Commissioner for all other "recognized" securities products. This does not seem to be consistent with the long history of investor protection that has been the trademark, if you will, of Kansas that long ago gave this country its first "Blue Sky Laws".

**On a cost benefit basis it would seem most efficient for the Securities Commissioner to have the plenary authority necessary to regulate what is, after all, a packaged securities product.** Common sense and sound fiscal policy should prevail. Effective, efficient, securities regulation by the appropriate regulatory body should be the Legislature's goal in this instance. **To not pass House Bill No. 2243 would be contrary to the public interest,** would not advance investor protection, and simply continue the status quo with Kansas residents at risk and disadvantage in a difficult marketplace.

I hope those comments prove helpful to you and your associates as you further deliberate this significant legislation. I would be pleased to answer any questions concerning my submission and you may reach me at (763) 847-7517.

Sincerely,



Jack Rosenfield





**Elizabeth (Betsy) Rohleder, CLU, ChFC**  
*Registered Principal*

February 7, 2001

Representative Ray Cox  
Chair, House Financial Institutions Committee  
State Capitol  
Topeka KS 66612

**RE: Letter of Support for HB2243**

Dear Representative Cox:

I am writing **to support HB2243**. This letter may be used and distributed, if appropriate, during testimony at the hearing on February 12<sup>th</sup>.

I am a licensed insurance agent and a registered representative, selling insurance as well as securities in Kansas. I sell both Variable Annuity and Variable Life contracts when it is appropriate in my clients' planning. I have been "in the business" of insurance since 1979 and have had my securities registration since 1986. I work full time in my own firm, Rohleder Financial Services and use Securities America Inc. as my broker dealer. I am affiliated with Securities America Advisors Inc. as an Investment Advisor Representative. I am a current member of Kansas Association of Insurance and Financial Advisors (KAIFA) and the Northeast Kansas Society of Financial Service Professionals.

As I understand current Federal Law, variable products have been determined to be securities. I believe that the Securities Commissioner's office should regulate those activities that involve securities.

I am **not** saying that the Securities Commissioner should now regulate insurance products or companies. For insurance products NOT considered securities, I am very comfortable with the current system of oversight and regulation by the Insurance Commissioner. It is my understanding that the Insurance Commissioner will retain exclusive jurisdiction over the insurance companies issuing variable products.

If an agent is NOT registered to sell mutual funds, but is selling a product that has mutual funds *inside* of the annuity or life product, I believe that he/she should have the appropriate state securities registration before advising the public to purchase those products.

In addition, I have read the amendments and understand that I, as a securities representative, will not have any additional fees or licenses required since I am already licensed to sell mutual funds. Nor will I be subject to any additional requirements from the Securities Commissioner.

In our industry we constantly face criticism over ethical conduct and client-appropriate recommendations (suitability). In my opinion, we should not be fearful of having our work overseen or regulated by the appropriate agencies. In my case I have no problem with the oversight of my insurance selling by the Insurance Commissioner and oversight of my securities sales by the Securities Commissioner.

I also believe customers will be better served when those agents who DO have reason to be investigated and cited for such things as fraud or other violations of the securities laws can be removed from doing further securities business with consumers.

Since I am not available to testify in person on February 12, I do hope you will take my written opinions into consideration. The overall effect of these amendments will be to ensure that the Kansas definition of *securities* conforms to federal law and allow functional regulation of complaints regarding variable products. I am in favor of this bill. I believe it strengthens our industry and better protects consumers.

Sincerely,



Betsy Rohleder



# JAMES N. REARDON

CERTIFIED FINANCIAL PLANNER  
1836 S.W. OAKLEY TOPEKA, KANSAS 66604  
(913) 233-7795

February 9, 2001

Rep. Ray Cox, Chairman  
House Financial Institutions Committee  
State Capitol  
Topeka, KS 66612

Dear Representative Cox:

It has come to my attention that at last a bill has been introduced to address one of the "Great Mysteries" of the financial advisory business. I had always assumed that the Office of the Kansas Securities Commissioner regulated variable annuities as well as mutual funds and other securities. The logic for any other arrangement defies me.

I entered the financial planning business through the insurance industry. I became licensed in the early 1980's. The Life Underwriters Training Courses were conducted at the SBG Building by one of the best insurance agents of his day--Jim McHenry. *Jim taught us that the value of life insurance and annuities lay in the guarantees.* We were cautioned against marketing them as investments.

In those days life insurance and annuities had firm guarantees. If you bought cash value insurance you knew

- what the premium would be,
- what the death benefit would be
- what the minimum interest rate would be

The only thing that was uncertain was whether the policy's cash value would exceed the minimum interest guarantee. It wasn't a sexy product but it was honest and it worked.

In the early 1980's the insurance industry introduced Universal Life, a product which agents were told, would behave more like an investment. It would earn lots of money and customers would be able to make their premiums "vanish." Some agents interpreted this to mean that their customer's policies would be "paid up."

**Consumer Reports** gamely pointed out that "Universal Life" was big on promise and very short on guarantees. They termed it "*a pig in a poke*" because--

- The death benefit could change
- The premium could change
- Mortality and Administrative expenses could change
- Projected cash values were highly unlikely based on historic performance

The only real *guarantee* was the minimum interest rate.



The sounds you are hearing throughout the life insurance industry today are the sounds of “universal” life insurance policies imploding as projections failed to be met; premiums *didn't* vanish; and inadequate cash values failed to sustain many of the products.

The purpose of an annuity (and the reason for giving it tax benefits) was to provide a retiree with *guaranteed income you can't outlive*. Aging schoolteachers could supplement their teaching pensions by putting their money into annuities that promised to provide them with a guaranteed steady and set income for the rest of their lives. It wasn't sexy but it was honest and it worked. *Fixed* annuities retain these same features.

### **Variable Annuities are a different product.**

In many ways, the word “Variable” is synonymous with the term “Universal.” It means “the absence of meaningful guarantees.” Variable Life Insurance is the ultimate meaningless product from a *guarantee* standpoint. It is a “variable” investment product on a “universal” life chassis. Many of its sub-accounts offer no guarantees whatsoever.

This may sound like I am not a fan of variable annuities but the truth is, I have my own money in variable annuities and I often recommend them to my clients. Variable annuities have a place for certain types of clients and a variety of planning applications.

Variable Annuities are investment products juiced up with certain life insurance industry guarantees that may, or may not add value to the product. The major attraction from a financial planning view point, is the tax deferral the annuity “wrapper” gives to the investment. The variable annuity has less value when used in a retirement plan.

Variable Annuities are rarely marketed to provide *lifetime income you can't outlive*. They are marketed to enhance results through tax savings. All kinds of securities are being marketed within these insurance company wrappers. I recently saw an annuity that offered only two sub accounts--for *options strategies*.

### **A variable annuity owner rarely knows that he or she has purchased an annuity.**

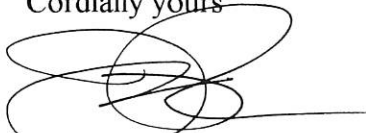
For the most part, they have purchased the annuity to get the services the mutual fund money manager who manages the sub-account because their registered rep advised them to do so. Many people who are invested in variable annuities are not even aware the product is an insurance product. If you find this hard to believe, interview a number of state employees who regularly contribute to the State's 457 Deferred Compensation plan. Simply ask them what company they invest their money with. Mutual Fund names will come forth.

Annuities that offer securities as investment sub-accounts are clearly securities as defined by the U.S. Supreme Court. They are regulated at the national level by the Securities Exchange Commission and require a Securities License to offer. What logic would suggest that any other regulator than the Kansas Securities Commissioner should regulate them? Is the Insurance Commissioners office even staffed properly to regulate them?

I question whether the Kansas Insurance Commissioner's Office even wants to regulate annuities offering option strategies and other "variable" investments. With the federal government initiative underway to modernize the way financial institutions do business, it seems like the ideal time to take the mystery out of the regulation of variable annuities.

Thanks for allowing me to share these observations with you.

Cordially yours

A handwritten signature in black ink, consisting of several overlapping loops and a horizontal line extending to the right.

Jim Reardon, J.D., CFP





# Variable Annuities: What You Should Know

Variable annuities have become a part of the retirement and investment plans of many Americans. Before you buy a variable annuity, you should know some of the basics – and be prepared to ask your insurance agent, broker, financial planner, or other financial professional lots of questions about whether a variable annuity is right for you.

This is a general description of variable annuities – what they are, how they work, and the charges you will pay. Before buying any variable annuity, however, you should find out about the particular annuity you are considering. Request a prospectus from the insurance company or from your financial professional, and read it carefully. The prospectus contains important information about the annuity contract, including fees and charges, investment options, death benefits, and annuity payout options. You should compare the benefits and costs of the annuity to other variable annuities and to other types of investments, such as mutual funds.

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## What Is a Variable Annuity?

A variable annuity is a contract between you and an insurance company, under which the insurer agrees to make periodic payments to you, beginning either immediately or at some future date. You purchase a variable annuity contract by

making either a single purchase payment or a series of purchase payments.

A variable annuity offers a range of investment options. The value of your investment as a variable annuity owner will vary depending on the performance of the investment options you choose. The investment options for a variable annuity are typically mutual funds that invest in stocks, bonds, money market instruments, or some combination of the three.

Although variable annuities are typically invested in mutual funds, variable annuities differ from mutual funds in several important ways:

First, variable annuities let you receive **periodic payments** for the rest of your life (or the life of your spouse or any other person you designate). This feature offers protection against the possibility that, after you retire, you will outlive your assets.

Second, variable annuities have a **death benefit**. If you die before the insurer has started making payments to you, your beneficiary is guaranteed to receive a specified amount – typically, at least the amount of your purchase payments. Your beneficiary will get a benefit from this feature if, at the time of your death, your account value is less than the guaranteed amount.

Third, variable annuities are **tax-deferred**. That means you pay no taxes on the income and investment gains from your annuity until you withdraw your money. You may also transfer your money from one investment option to another within a variable annuity without paying tax at the time of the transfer. When you take your money out of a variable annuity, however, you will be taxed on the earnings at ordinary income tax rates rather than lower capital gains rates. In general, the benefits of tax deferral will outweigh the costs of a variable annuity only if you hold it as a long-term investment to meet retirement and other long-range goals.



Other investment vehicles, such as IRAs and employer-sponsored 401(k) plans, also may provide you with tax-deferred growth and other tax advantages. For most investors, it will be advantageous to make the maximum allowable contributions to IRAs and 401(k) plans before investing in a variable annuity.

In addition, if you are investing in a variable annuity through a tax-advantaged retirement plan (such as a 401(k) plan or IRA), you will get **no additional tax advantage** from the variable annuity. Under these circumstances, consider buying a variable annuity only if it makes sense because of the annuity's other features, such as lifetime income payments and death benefit protection. The tax rules that apply to variable annuities can be complicated – before investing, you may want to consult a tax adviser about the tax consequences to you of investing in a variable annuity.

**Remember:** Variable annuities are designed to be long-term investments, to meet retirement and other long-range goals.

Variable annuities are not suitable for meeting short-term goals because substantial taxes and insurance company charges may apply if you withdraw your money early. Variable annuities also involve investment risks, just as mutual funds do.



## How Variable Annuities Work

A variable annuity has two phases: an **accumulation phase** and a **payout phase**.

During the **accumulation phase**, you make purchase payments, which you can allocate to a number of investment options. For example, you could designate 40% of your purchase payments to a bond fund, 40% to a U.S. stock fund, and 20% to an international stock fund. The money you have allocated to each mutual fund investment option will increase or decrease over time, depending on the fund's performance. In addition, variable annuities often allow you to allocate part of your purchase payments to a fixed account. A fixed account, unlike a mutual fund, pays a fixed rate of interest. The insurance company may reset this interest rate periodically, but it will usually provide a guaranteed minimum (e.g., 3% per year).

**Example:** You purchase a variable annuity with an initial purchase payment of \$10,000. You allocate 50% of that purchase payment (\$5,000) to a bond fund, and 50% (\$5,000) to a stock fund. Over the following year, the stock fund has a 10% return, and the bond fund has a 5% return. At the end of the year, your account has a value of \$10,750 (\$5,500 in the stock fund and \$5,250 in the bond fund), minus fees and charges (discussed below).

Your most important source of information about a variable annuity's investment options is the prospectus. Request the prospectuses for the mutual fund investment options. Read them carefully before you allocate your purchase payments among the investment options offered. You should consider a variety of factors with respect to each fund option, including the fund's investment objectives and policies, management fees and other expenses that the fund charges, the risks and volatility of the fund, and whether the fund contributes to the diversification of your overall investment portfolio. The SEC's online publication, *Mutual Fund Investing: Look at More Than a Fund's Past Performance*, provides information about these factors. Another SEC online publication, *Invest Wisely: An Introduction to Mutual Funds*, provides general information about the types of mutual funds and the expenses they charge.

During the accumulation phase, you can typically transfer your money from one investment option to another without paying tax on your investment income and gains, although you may be charged by the insurance company for transfers. However, if you withdraw money from your account during the early years of the accumulation phase, you may have to pay "surrender charges," which are

discussed below. In addition, you may have to pay a 10% federal tax penalty if you withdraw money before the age of 59½.

At the beginning of the **payout phase**, you may receive your purchase payments plus investment income and gains (if any) as a lump-sum payment, or you may choose to receive them as a stream of payments at regular intervals (generally monthly).

If you choose to receive a stream of payments, you may have a number of choices of how long the payments will last. Under most annuity contracts, you can choose to have your annuity payments last for a period that you set (such as 20 years) or for an indefinite period (such as your lifetime or the lifetime of you and your spouse or other beneficiary). During the payout phase, your annuity contract may permit you to choose between receiving payments that are fixed in amount or payments that vary based on the performance of mutual fund investment options.

The amount of each periodic payment will depend, in part, on the time period that you select for receiving payments. Be aware that some annuities do not allow you to withdraw money from your account once you have started receiving regular annuity payments.

In addition, some annuity contracts are structured as **immediate annuities**, which means that there is no accumulation phase and you will start receiving annuity payments right after you purchase the annuity.

## The Death Benefit and Other Features

A common feature of variable annuities is the **death benefit**. If you die, a person you select as a beneficiary (such as your spouse or child) will receive the greater of: (i) all the money in your account, or (ii) some guaranteed minimum (such as all purchase payments minus prior withdrawals).

**Example:** You own a variable annuity that offers a death benefit equal to the greater of account value or total purchase payments minus withdrawals. You have made purchase payments totaling \$50,000. In addition, you have withdrawn \$5,000 from your account. Because of these withdrawals and investment losses, your account value is currently \$40,000. If you die, your designated beneficiary will receive \$45,000 (the \$50,000 in purchase payments you put in minus \$5,000 in withdrawals).

Some variable annuities allow you to choose a **"stepped-up" death benefit**. Under this feature, your guaranteed minimum death benefit may be based on a greater amount than purchase payments minus withdrawals. For example, the guaranteed minimum might be your account value as of a specified date, which may be greater than purchase payments minus withdrawals if the underlying investment options have performed well. The purpose of a stepped-up death benefit is to "lock in" your investment performance and prevent a later decline in the value of your account from eroding the amount that you expect to leave to your heirs. This feature carries a charge, however, which will reduce your

account value.

Variable annuities sometimes offer other optional features, which also have extra charges. One common feature, the **guaranteed minimum income benefit**, guarantees a particular minimum level of annuity payments, even if you do not have enough money in your account (perhaps because of investment losses) to support that level of payments. Other features may include **long-term care insurance**, which pays for home health care or nursing home care if you become seriously ill.

You may want to consider the financial strength of the insurance company that sponsors any variable annuity you are considering buying. This can affect the company's ability to pay any benefits that are greater than the value of your account in mutual fund investment options, such as a death benefit, guaranteed minimum income benefit, long-term care benefit, or amounts you have allocated to a fixed account investment option.



You will pay for each benefit provided by your variable annuity. Be sure you understand the charges. Carefully consider whether you need the benefit. If you do, consider whether you can buy the benefit more cheaply as part of the variable annuity or separately (e.g., through a long-term care insurance policy).



## Variable Annuity Charges

You will pay several charges when you invest in a variable annuity. Be sure you understand all the charges before you invest. **These charges will reduce the value of your account and the return on your investment.** Often, they will include the following:



**Surrender charges** – If you withdraw money from a variable annuity within a certain period after a purchase payment (typically within six to eight years, but sometimes as long as ten years), the insurance company usually will assess a "surrender" charge, which is a type of sales charge. This charge is used to pay your financial professional a commission for selling the variable annuity to you. Generally, the surrender charge is a percentage of the amount withdrawn, and declines gradually over a period of several years, known as the "**surrender period**." For example, a 7% charge might apply in the first year after a purchase payment, 6% in the second year, 5% in the third year, and so on until the eighth year, when the surrender charge no longer applies. Often, contracts will allow you to withdraw part of your account value each year – 10% or 15% of your account value, for example – without paying a surrender charge.



beginning with a 7% charge in the first year, and declining by 1% each year. In addition, you are allowed to withdraw 10% of your contract value each year free of surrender charges. In the first year, you decide to withdraw \$5,000, or one-half of your contract value of \$10,000 (assuming that your contract value has not increased or decreased because of investment performance). In this case, you could withdraw \$1,000 (10% of contract value) free of surrender charges, but you would pay a surrender charge of 7%, or \$280, on the other \$4,000 withdrawn.

- Mortality and expense risk charge** – This charge is equal to a certain percentage of your account value, typically in the range of 1.25% per year. This charge compensates the insurance company for insurance risks it assumes under the annuity contract. Profit from the mortality and expense risk charge is sometimes used to pay the insurer's costs of selling the variable annuity, such as a commission paid to your financial professional for selling the variable annuity to you.

**Example:** Your variable annuity has a mortality and expense risk charge at an annual rate of 1.25% of account value. Your average account value during the year is \$20,000, so you will pay \$250 in mortality and expense risk charges that year.

- Administrative fees** – The insurer may deduct charges to cover record-keeping and other administrative expenses. This may be charged as a flat account maintenance fee (perhaps \$25 or \$30 per year) or as a percentage of your account value (typically in the range of 0.15% per year).

**Example:** Your variable annuity charges administrative fees at an annual rate of 0.15% of account value. Your average account value during the year is \$50,000. You will pay \$75 in administrative fees.

- Underlying Fund Expenses** – You will also indirectly pay the fees and expenses imposed by the mutual funds that are the underlying investment options for your variable annuity.

- Fees and Charges for Other Features** – Special features offered by some variable annuities, such as a stepped-up death benefit, a guaranteed minimum income benefit, or long-term care insurance, often carry additional fees and charges.

Other charges, such as initial sales loads, or fees for transferring part of your account from one investment option to another, may also apply. You should ask your financial professional to explain to you all charges that may apply. You can also find a description of the charges in the prospectus for any variable annuity that you are considering.

## Tax-Free "1035" Exchanges

Section 1035 of the U.S. tax code allows you to exchange an existing variable annuity contract for a new annuity contract without paying any tax on the income and investment gains in your current variable annuity account. These tax-free exchanges, known as 1035 exchanges, can be useful if another annuity has features that you prefer, such as a larger death benefit, different annuity payout options, or a wider selection of investment choices.

You may, however, be required to pay surrender charges on the old annuity if you are still in the surrender charge period. In addition, a new surrender charge period generally begins when you exchange into the new annuity. This means that, for a significant number of years (as many as 10 years), you typically will have to pay a surrender charge (which can be as high as 9% of your purchase payments) if you withdraw funds from the new annuity. Further, the new annuity may have higher annual fees and charges than the old annuity, which will reduce your returns.



If you are thinking about a 1035 exchange, you should compare both annuities carefully. Unless you plan to hold the new annuity for a significant amount of time, you may be better off keeping the old annuity because the new annuity typically will impose a new surrender charge period. Also, if you decide to do a 1035 exchange, you should talk to your financial professional or tax adviser to make sure the exchange will be tax-free. If you surrender the old annuity for cash and then buy a new annuity, you will have to pay tax on the surrender.



### Bonus Credits

Some insurance companies are now offering variable annuity contracts with "bonus credit" features. These contracts promise to add a bonus to your contract value based on a specified percentage (typically ranging from 1% to 5%) of purchase payments.

**Example:** You purchase a variable annuity contract that offers a bonus credit of 3% on each purchase payment. You make a purchase payment of \$20,000. The insurance company issuing the contract adds a bonus of \$600 to your account.



Variable annuities with bonus credits may carry a downside, however – higher expenses that can outweigh the benefit of the bonus credit offered.

Frequently, insurers will charge you for bonus credits in one or more of the following ways:



**Higher surrender charges** – Surrender charges may be higher for a variable annuity that pays you a bonus credit than for a similar contract with no bonus credit.



**Longer surrender periods** – Your purchase payments may be subject to surrender charges for a longer period than they would be under a similar contract with no bonus credit.



**Higher mortality and expense risk charges and other charges** – Higher annual mortality and expense risk charges may be deducted for a variable annuity that pays you a bonus credit. Although the difference may seem small, over time it can add up. In addition, some contracts may impose a separate fee specifically to pay for the bonus credit.

Before purchasing a variable annuity with a bonus credit, ask yourself – and the financial professional who is trying to sell you the contract – whether the bonus is worth more to you than any increased charges you will pay for the bonus. This may depend on a variety of factors, including the amount of the bonus credit and the increased charges, how long you hold your annuity contract, and the return on the underlying investments. You also need to consider the other features of the annuity to determine whether it is a good investment for you.

**Example:** You make purchase payments of \$10,000 in Annuity A and \$10,000 in Annuity B. Annuity A offers a bonus credit of 4% on your purchase payment, and deducts annual charges totaling 1.75%. Annuity B has no bonus credit and deducts annual charges totaling 1.25%. Let's assume that both annuities have an annual rate of return, prior to expenses, of 10%. By the tenth year, your account value in Annuity A will have grown to \$22,978. But your account value in Annuity B will have grown more, to \$23,136, because Annuity B deducts lower annual charges, even though it does not offer a bonus.

You should also note that a bonus may only apply to your initial premium payment, or to premium payments you make within the first year of the annuity contract. Further, under some annuity contracts the insurer will take back all bonus payments made to you within the prior year or some other specified period if you make a withdrawal, if a death benefit is paid to your beneficiaries upon your death, or in other circumstances.



If you already own a variable annuity and are thinking of exchanging it for a different annuity with a bonus feature, you should be careful. Even if the surrender period on your current annuity contract has expired, a new surrender period generally will begin when you exchange that contract for a new one. This means that, by

exchanging your contract, you will forfeit your ability to withdraw money from your account without incurring substantial surrender charges. And as described above, the schedule of surrender charges and other fees may be higher on the variable annuity with the bonus credit than they were on the annuity that you exchanged.

**Example:** You currently hold a variable annuity with an account value of \$20,000, which is no longer subject to surrender charges. You exchange that annuity for a new variable annuity, which pays a 4% bonus credit and has a surrender charge period of eight years, with surrender charges beginning at 9% of purchase payments in the first year. Your account value in this new variable annuity is now \$20,800. During the first year you hold the new annuity, you decide to withdraw all of your account value because of an emergency situation. Assuming that your account value has not increased or decreased because of investment performance, you will receive \$20,800 minus 9% of your \$20,000 purchase payment, or \$19,000. This is \$1,000 less than you would have received if you had stayed in the original variable annuity, where you were no longer subject to surrender charges.

► **In short:** Take a hard look at bonus credits. In some cases, the "bonus" may not be in your best interest.

## Ask Questions Before You Invest

Financial professionals who sell variable annuities have a duty to advise you as to whether the product they are trying to sell is suitable to your particular investment needs. Don't be afraid to ask them questions. And write down their answers, so there won't be any confusion later as to what was said.

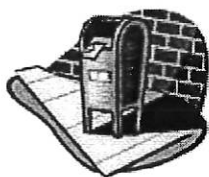
Variable annuity contracts typically have a "free look" period of ten or more days, during which you can terminate the contract without paying any surrender charges and get back your purchase payments (which may be adjusted to reflect charges and the performance of your investment). You can continue to ask questions in this period to make sure you understand your variable annuity before the "free look" period ends.

Before you decide to buy a variable annuity, consider the following questions:

- Will you use the variable annuity primarily to save for retirement or a similar long-term goal?
- Are you investing in the variable annuity through a retirement plan or IRA (which would mean that you are not receiving any additional tax-deferral benefit from the variable annuity)?
- Are you willing to take the risk that your account value may decrease if the underlying mutual fund investment options perform badly?

- Do you understand the features of the variable annuity?
- Do you understand all of the fees and expenses that the variable annuity charges?
- Do you intend to remain in the variable annuity long enough to avoid paying any surrender charges if you have to withdraw money?
- If a variable annuity offers a bonus credit, will the bonus outweigh any higher fees and charges that the product may charge?
- Are there features of the variable annuity, such as long-term care insurance, that you could purchase more cheaply separately?
- Have you consulted with a tax adviser and considered all the tax consequences of purchasing an annuity, including the effect of annuity payments on your tax status in retirement?
- If you are exchanging one annuity for another one, do the benefits of the exchange outweigh the costs, such as any surrender charges you will have to pay if you withdraw your money before the end of the surrender charge period for the new annuity?

**Remember:** Before purchasing a variable annuity, you owe it to yourself to learn as much as possible about how they work, the benefits they provide, and the charges you will pay.



## For More Information

### Other SEC Online Publications

- *Invest Wisely: An Introduction to Mutual Funds* – Basic information about investing in mutual funds. Much of this information applies to variable annuities, as well.
- *Mutual Fund Investing: Look at More Than a Fund's Past Performance* – Describes some of the factors you should consider in choosing a mutual fund.
- *Mutual Fund Cost Calculator* – Allows you to compare the total costs of owning different mutual funds.
- *Ask Questions* – Questions you should ask about all of your investments, the people who sell them to you, and what to do if you run into problems.



**HOUSE BILL No. 2243**  
**Reasons to Support Amendments regarding Variable Products**

**1. UNIFORMITY**

- a. New Uniform Securities Act being drafted includes variable products.  
*ACLI failed to persuade a drafting committee of leading private securities lawyers to not include variable products in the definition of securities.*
- b. Change in definition would be consistent with federal law.  
*Variable products have been determined by the U.S. Supreme Court to be securities.*
- c. Eight states already define securities to include variable annuities and at least fourteen states require securities licenses for agents that sell variable products.

**2. VARIABLE PRODUCTS ARE PROMOTED AS “INVESTMENTS”**

- a. Consumers are confused by our current outdated and disjointed regulatory structure:  
*If complaints about an agent’s sale of **ABC Mutual Fund** are handled by the Securities Commissioner... Why should complaints about an agent’s sale of a variable product invested in **ABC Mutual Fund** be exclusively handled by the Insurance Commissioner?*
- b. Financial Modernization promotes “one stop shopping” and “functional regulation”... Thus, agents who sell investment products such as variable annuities should be subject to regulation by the Securities Commissioner.
- c. Agents who have been revoked or barred from selling securities, including mutual funds, should not be allowed to sell variable products with mutual fund subaccounts.

**3. NO ADDITIONAL COST OR BURDEN ON AGENTS OR INDUSTRY**

- a. No additional fees or licenses for most agents.  
*Most agents selling variable products also are licensed to sell mutual funds.*
- b. Will not affect insurance companies who issue variable products.  
*Exclusive jurisdiction over insurance companies and their products will remain with the Insurance Commissioner.*

**4. THERE IS NO REGULATOR OF STATE-REGISTERED FINANCIAL PLANNERS AND INVESTMENT ADVISERS REGARDING VARIABLE PRODUCTS**

- a. The state securities commissioner is the sole regulator of investment advisers managing less than \$25 million in assets and jurisdiction arguably only applies to advice regarding “securities” which currently excludes variable products.

**HOUSE BILL No. 2243**  
**Questions to ask the Opponents**

How can this be additional regulation for insurance companies when they are not affected and are not subject to any regulation by the Securities Commissioner?

If the proposed amendments are so burdensome and unnecessary, why have not the insurance companies and insurance agents worked to change the laws and regulations in the eight states that consider variable products as securities?

Why have not the insurance companies and insurance agents sought relief from Congress when two major pieces of regulatory legislation were passed (NSMIA in 1996 and GLBA in 1999)?

What is unreasonable if no new fees, filings, or forms will be required of broker-dealers or agents?

Testimony of

**Carl B. Wilkerson, Chief Counsel, Securities  
of the American Council of Life Insurers**

**Before the Committee on Financial Institutions  
on House Bill No. 2243**

**February 12, 2001**

The American Council of Life Insurers greatly appreciates the opportunity to share its views on House Bill No. 2243. Our 426 members represent 80 percent of the total assets all legal reserve life insurance companies in the United States, and account for 81 percent of annuity considerations, and 80 percent of life insurance premiums in the United States. 340 of our members are licensed to conduct business in Kansas. Many of our members manufacture and distribute variable life insurance and variable annuities.

We oppose House Bill No. 2243. Three aspects of the bill are particularly troubling to life insurance companies:

- House Bill No. 2243 would modify the Kansas Insurance Commissioner's sole and exclusive authority to regulate the issuance and sale of variable life insurance and variable annuities.<sup>1</sup>

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<sup>1</sup>House Bill No. 2243 would amend the variable contract law in the Kansas insurance code at 5. K.S.A. 40-436(l) as follows:

*"The commissioner shall have the sole and exclusive jurisdiction and authority to regulate the ~~issuance and sale of~~ terms and provisions in such contracts and the obligations of insurance companies under such contracts and to promulgate such reasonable rules and regulations as may be necessary to carry out the purposes and provisions of this act, ~~and such contracts, the companies which issue them, and~~*

- House Bill No. 2243 would also subject variable life insurance and variable annuities to the Kansas Securities Code for the first time.<sup>2</sup>
- In scope and purpose, House Bill No. 2243 governs matters substantially similar to House Bill No. 2690 that the Committee evaluated and rejected in February 2000. Nothing has occurred to warrant reconsideration of these issues in 2001.

### Summary of Position

- Variable life insurance and variable annuities are one of the most heavily regulated financial products in today's broad marketplace.
- HB 2243 would disrupt a coordinated system of state and federal regulation established by the U.S. Supreme Court.

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~~the agents or other persons who sell them, shall not be subject to the provisions of article 12 of chapter 17 of the Kansas Statutes Annotated nor to the jurisdiction of the securities commissioner of this state."~~

<sup>2</sup>The bill would amend the definition of "security" under the Kansas securities statute at K.S.A. 17-125(j) to provide that:

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

- The bill would cause duplicate regulation of the same product under the Kansas Insurance and Securities Codes.
- HB 2243 would create expensive, unnecessary compliance burdens for life insurers and salespersons, and would discourage life insurers from distributing variable life insurance and variable annuities in Kansas.
- The bill would impose a fourth layer of regulation on variable life insurance and variable annuities on top of comprehensive SEC, NASD, and state insurance regulation.
- The need for amendment to the Kansas Securities Code has not been justified. A pattern of abuse has not been identified. Expanded jurisdiction is not warranted.
- HB 2243 creates an aberrant regulatory structure in Kansas that differs from almost every other state. In altering the Kansas Insurance Commissioner's jurisdiction, the bill could impair domestic insurers' ability to obtain approval in foreign jurisdictions.

### **Background**

Variable contracts are perhaps the most heavily regulated financial products in today's broad marketplace. The U.S. Supreme Court observed that variable contracts possess important characteristics of both insurance and securities, and ruled that their securities characteristics are



subject to federal securities regulation, while their insurance characteristics are subject to state insurance regulation.<sup>3</sup> In the manufacture and distribution of variable contracts, therefore, life insurers satisfy multiple state and federal layers of regulation.

Variable contract separate accounts must be registered under the Investment Company Act of 1940, which is administered by the U.S. Securities and Exchange Commission. The disclosure appearing in variable contract prospectuses is reviewed and approved by the SEC. Advertisements must satisfy several detailed regulations under the federal securities laws, and must be filed with the SEC.

Variable contracts subject to the federal securities laws can only be sold by registered representatives of a broker-dealer that is a member of the National Association of Securities Dealers. The NASD's rules of conduct strictly govern the activity of securities salespersons, and impose detailed standards concerning advertising, supervision and the suitability of individual securities transactions. All advertisements used by NASD licensed salespersons must be filed with, and approved by, the NASD Advertising Department.

Activities of securities salespersons are also subject to SEC jurisdiction under the Securities Exchange Act of 1934. In addition to these specific standards, the federal securities laws impose broad antifraud proscriptions and give the SEC significant enforcement authority.

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<sup>3</sup>*SEC v. Variable Annuity Life Insurance Company*, 359 U.S. 65 (1959); *SEC v. United Benefit Life Insurance Company*, 387 U.S. 202 (1967).

Unlike other regulatory structures, the federal securities laws uniquely provide for private rights of actions by individual investors on certain core protections.

State insurance departments have comprehensive authority over life insurers and the products they issue. In addition to the variable contract statutes and regulations in most jurisdictions, variable life and variable annuities must also satisfy a broad array of requirements protecting the interests of consumers, such as unfair trade practices acts, illustration regulations, and advertising regulations. State insurance departments wield substantial authority over variable contracts in the issuance of variable contract certificates of authority, and in policy form filing and approval. State insurance departments also continually evaluate insurers and their product distribution through very detailed market conduct examinations.

### **The Burdens of Conflicting State and Federal Standards**

Life insurers must satisfy multiple, comprehensive state and federal regulatory structures in developing and selling variable life and variable annuities. The financial services market in which variable contracts are distributed is extremely competitive and fast-moving. The delay and added expense caused by regulatory conflicts can significantly burden the marketability and competitiveness of variable contracts. Further, life insurers are untenably caught in an irreconcilable position when faced with inconsistent interpretations from a single insurance regulator that contradict the standards and interpretations of federal regulators and other state insurance departments.

## Chronology From Design to Regulatory Approval

The regulatory chronology insurers confront in bringing a variable contract to market may help illustrate the burdens of inconsistent regulation. After substantial investment in the design and mechanics of a variable life and variable annuity, actuaries price and identify the product to uniquely position it in the marketplace. Following this process, a life insurer must register a separate account funding the variable contract with the SEC under the federal securities laws. At this stage, SEC staff meticulously review the registration and its prospectus for completeness and clarity, screening against material omissions or materially misleading statements. By this juncture, life insurers have invested substantial time and funds for accounting, legal and registration fees. With the product's approval under the federal securities laws, life insurers commit substantial resources to the systems supporting the product and its marketing. By the end of the SEC registration process, the identity and name of the variable annuity contract has been crystallized.

Following SEC approval, life insurers must have certificates of authority and policy form approval for the new variable contract from their domestic state and each state in which the variable contract will be marketed. Additionally, life insurers must fulfill comprehensive regulatory requirements in each state where they conduct business, based on standards patterned after NAIC model laws and regulations.

Kansas has enacted comprehensive laws and adopted regulations governing the

manufacture and distribution of variable life insurance and variable annuities based on the NAIC model laws and regulations. These laws and regulations grant the insurance commissioner sole and exclusive jurisdiction to regulate these products, and follows the practice in almost every jurisdiction. This approach to regulation dovetails with the joint state and federal regulation of this product according to the standards established by the U.S. Supreme Court.

Salespersons distributing variable contracts must obtain an NASD license in order to sell these products, and must maintain rigorous continuing education standards. Supervising broker-dealers enforce the NASD's rigorous rules of conduct, and fulfill significant supervision and suitability standards. Individuals committing felonies and dishonesty crimes are statutorily disqualified from being NASD licensed. Broker-dealers immediately must report salespersons terminated for cause on Form U-5, which is available on the NASD's publicly available computerized database, the CRD.

In sum, variable life and annuities pass meticulous scrutiny from design through approval.

### **Costs and Benefits of the Bill**

The need for the amendments has not been substantiated. No pattern of abuse has been cited. In our view, the desire for the amended statutes stems from a conceptual theory of expanded securities jurisdiction that is unfounded and incorrect. Adequate means already exist

under the Kansas laws and regulations to police and prosecute market conduct matters. Subjecting variable life and annuities to the Kansas securities laws provides little regulatory value beyond that of the Kansas Insurance Commission, the SEC and the NASD.

Duplicate, shared jurisdiction in Kansas over the same product will inevitably lead to expensive, untenable regulatory conflicts. The added cost of redundant regulation could deter the continued sale of variable contracts in Kansas. This consequence unnecessarily harms Kansas consumers by choking competition, and erects disincentives to conduct insurance and annuity business in Kansas.

The Kansas Office of the Securities Commissioner lacks any specialized expertise concerning the creation, operation and sale of variable annuities or variable life insurance. Granting the Securities Commissioner authority to regulate these insurance products is unnecessary and inappropriate because the Kansas Insurance Commissioner has ample resources, expertise and statutory authority to comprehensively regulate the issuance and sale of variable life insurance and annuities. There has been no demonstration that the Kansas Insurance Commissioner is unable to vigorously regulate the issuance and sale of variable products, and to aggressively address any problems in the marketplace.

On balance, the economic burdens of the bill's amendments greatly overshadow its nebulous, unsubstantiated regulatory benefits.



## Mischaracterization of House Bill No. 2243

The Kansas Securities Commissioner's legislative digest dated January 24, 2001, mischaracterizes House Bill No. 2243 . The Commissioner's *2001 Legislative Proposal* cites the Gramm-Leach-Bliley Act ("GLB") as a basis for state securities jurisdiction over the marketing of variable life insurance and variable annuities. GLB established important principles of functional financial service institution regulation. It did not, however, authorize duplicate and overlapping patterns of state regulation. In truth, the bill's redundant regulatory layering and shared jurisdiction over the same product is the antithesis of GLB's purpose and intent. Rather than modernizing the regulation of financial service institutions in Kansas, House Bill No. 2243 would establish disfunctional regulation and would thwart financial services modernization.

The Securities Commissioner's legislative digest explains that the amendment to Section 40-436(l) of the Kansas Insurance Code clarifies that "the Insurance Commissioner continues to retain exclusive jurisdiction over the issuers (insurance companies) and variable annuity contracts." In fact, the amendment alters and reduces the Insurance Commissioner's authority significantly.

The current law provides the Insurance Commissioner sole and exclusive jurisdiction to regulate the issuance and sale of variable contracts. In distinct contrast, House Bill No. 2243 would more narrowly grant the insurance commissioner sole and exclusive jurisdiction "to regulate the *terms and provisions* in such contracts *and the obligations of insurance companies under such contracts.*" This language reflects a substantial reduction in authority and does not

appear in any other state law. Moreover, House Bill No. 2243 would remove the current statute's complete ban on the Securities Commissioner's jurisdiction to regulate variable "contracts, the companies which issue them, and the agents or other persons who sell them."

### **Conclusion**

House Bill No. 2243 is a solution in search of a problem. Nothing has changed since the Committee reviewed and rejected a substantially similar bill last year. No patterns of unregulated problems in the marketplace have been offered. There has been no showing that the Insurance Commissioner lacks the expertise, resources or enforcement authority to comprehensively and aggressively regulate the issuance and sale of variable life insurance and variable annuities.

Enactment of House Bill No. 2243 would put Kansas in a small minority different from most other jurisdictions. The bill would add to the costs of doing business in Kansas and could injure consumers by discouraging the entry of additional competitors to the Kansas marketplace. Theoretical regulatory concerns provide inadequate foundation for enacting duplicative, aberrant schemes of regulation in Kansas.

For the reasons stated above, House Bill No. 2243 should be eliminated. We would be pleased to address any questions, and greatly appreciate your time and attention to our views.

THE STATUS OF VARIABLE CONTRACTS UNDER STATE SECURITIES AND INSURANCE LAWS			
State	Statute Granting Insurance Commissioner Exclusive Jurisdiction to Regulate Variable Contracts	Complete Exclusion from State Securities Code for <i>All</i> Insurance, Endowment and Annuity Contracts. Occurs Through Exclusion from the Definition of "Security"	Other Parallel Exclusions from State Securities Code
Alabama	§27-38-4	<sup>1</sup>	§ 8-6-2(10)
Alaska	§21.42.370(k)	§45.55.990 (12)	
Arizona	§20-651 (I)	<sup>2</sup>	
Arkansas	§23-81-405	§23-42-102(B)	
California	§10506(h)	§25019	
Colorado	§10-7-404 (l)	§11-51-201 (17)	
Connecticut	§ 38a-433(c)	§36b-3(17)	
Delaware	§2932(d)	§7302(13)	
D.C.	§35-639(f)	<sup>3</sup>	
Florida	§ 627.805	§517.051(10)	
Georgia	§33-11-65(h)	<sup>4</sup>	

<sup>1</sup> Definition of "security" in Alabama includes "annuity contract **unless** issued by an insurance company." [See, §8-6-2(10)]. Variable annuities issued by a life insurance company, therefore, are excluded from the definition of security in Alabama.

<sup>2</sup> No categories of any kind are excluded from the definition of security in Arizona. [See, § 44-1801(22)].

<sup>3</sup> Only fixed insurance, endowment and annuity contracts are excluded from the definition of security in the District of Columbia. [See, §2-2601(12)].

<sup>4</sup> Georgia statute refers only to variable *annuities* in the exclusion from the definition of security. Therefore, variable life insurance contracts are technically not within the exclusion, although exclusion of both variable annuities and variable life insurance contracts was probably intended by legislature. [See, §10-5-2(26)].

THE STATUS OF VARIABLE CONTRACTS UNDER STATE SECURITIES AND INSURANCE LAWS			
State	Statute Granting Insurance Commissioner Exclusive Jurisdiction to Regulate Variable Contracts	Complete Exclusion from State Securities Code for All Insurance, Endowment and Annuity Contracts. Occurs Through Exclusion from the Definition of "Security"	Other Parallel Exclusions from State Securities Code
Guam		§4501(l)	
Hawaii	§431:10D-118(d)	<sup>5</sup>	
Idaho	§41-1939(1)	§30-1402(12)	Bulletin 88-9
Illinois	5/245.24	<sup>6</sup>	
Indiana		§23-2-1-1(k)	
Iowa	§508A.4	§502.102(14)	
Kansas	§40-436(l)	§17-1252(j)	
Kentucky	§304.15-390(7)	<sup>7</sup>	
Louisiana	§1500(J)	<sup>8</sup>	
Maine	§2537(12)	§10501(18)	
Maryland	§16-601(b)	§11-101(r)(2)	
Massachusetts	§132G	§401(k)	

<sup>5</sup> Definition of "security" in Hawaii does not include any insurance or endowment policy or fixed *annuity* contract. Variable *life* insurance, therefore, is excluded from definition. [See, §485-1(13)].

<sup>6</sup> No exclusion from the definition of security for any type of insurance, endowment, or annuity contracts in Illinois. [See, §2.1].

<sup>7</sup> Only fixed insurance, endowment and annuity contracts are excluded from the definition of security in Kentucky [See, §292.310(18)]

<sup>8</sup> Only fixed insurance, endowment and annuity contracts are excluded from the definition of security in Louisiana. [See, §1500(15)(b)(i)].

By Carl B. Wilkerson, Chief Counsel-Securities, American Council of Life Insurers, September 6, 2000, ©2000 All Rights Reserved

<b>THE STATUS OF VARIABLE CONTRACTS UNDER STATE SECURITIES AND INSURANCE LAWS</b>			
<b>State</b>	<b>Statute Granting Insurance Commissioner Exclusive Jurisdiction to Regulate Variable Contracts</b>	<b>Complete Exclusion from State Securities Code for All Insurance, Endowment and Annuity Contracts. Occurs Through Exclusion from the Definition of "Security"</b>	<b>Other Parallel Exclusions from State Securities Code</b>
Michigan	§ 500.925, § 500.4000	§451.801(l)	
Minnesota	§§61A.18, 61A.20	§80A.14(18)(a)(l)	
Mississippi	§83-7-45	§83-7-45(n)	
Missouri	§83-7-45(6)	§409.401(o)	
Montana	§33-20-602	<sup>9</sup>	
Nebraska	§44-2220	§8-1101(13)	
Nevada	§ 688A.390(4)	<sup>10</sup>	
New Hampshire	§408:52	§421-B:2(XX)(a)	
New Jersey	§ 17B:28-14	§ 49:3-49(m)	

<sup>9</sup> Only fixed insurance, endowment and annuity contracts are excluded from the definition of security in Montana. [See, §30-10-103(22)(b)].

<sup>10</sup> Only fixed insurance, endowment and annuity contracts are excluded from the definition of security in Nevada. [See, §90.295(1)].



<b>THE STATUS OF VARIABLE CONTRACTS UNDER STATE SECURITIES AND INSURANCE LAWS</b>			
<b>State</b>	<b>Statute Granting Insurance Commissioner Exclusive Jurisdiction to Regulate Variable Contracts</b>	<b>Complete Exclusion from State Securities Code for All Insurance, Endowment and Annuity Contracts. Occurs Through Exclusion from the Definition of "Security"</b>	<b>Other Parallel Exclusions from State Securities Code</b>
New Mexico	§59A-20-30(E)	<sup>11</sup>	Opinion No. 69-97 Reaffirms Exclusive Authority of Insurance Commissioner and precludes Securities Commissioner jurisdiction
New York	§4240(7)	§359-ff(5)(f)	
North Carolina	§58-7-95(r)	§78A-2(11)	
North Dakota		<sup>12</sup>	
Ohio	§3911.011(C)	<sup>13</sup>	
Oklahoma	§6061(D) <sup>14</sup>	§71-1-2(W)	
Oregon		§§59.015 (19)(b)(A)	

<sup>11</sup> No exclusion from the definition of security for any type of insurance, endowment, or annuity contracts in New Mexico. [See, § 48-18-17(H)].

<sup>12</sup> No categories of any kind excluded from definition of security in North Dakota. [See, §10-04-02(15)].

<sup>13</sup> No categories of any kind excluded from definition of security in Ohio. [ See, §1707.01(B)].

<sup>14</sup> The statute's grant of exclusive jurisdiction to the Insurance Commissioner is unique in additionally stating that "the companies which issue them [variable contracts] and the agents or other persons who sell them shall not be subject to the Oklahoma Securities Act nor to the jurisdiction of the Oklahoma Securities Commission thereunder."

THE STATUS OF VARIABLE CONTRACTS UNDER STATE SECURITIES AND INSURANCE LAWS			
State	Statute Granting Insurance Commissioner Exclusive Jurisdiction to Regulate Variable Contracts	Complete Exclusion from State Securities Code for <i>All</i> Insurance, Endowment and Annuity Contracts. Occurs Through Exclusion from the Definition of "Security"	Other Parallel Exclusions from State Securities Code
Pennsylvania	§506.2(d) <sup>15</sup>	§1-102(t)(iii)	
Puerto Rico	§1334 <sup>16</sup>	<sup>17</sup>	
Rhode Island	§27-32-7	<sup>18</sup>	
South Carolina	§38-67-40	§35-1-20 (15)	

<sup>15</sup>The statute's grant of exclusive jurisdiction to the Insurance Commissioner has a unique added sentence which states: "Variable contracts, and agents or other persons who sell variable contracts, shall not be subject to the act of December 5, 1972 (P.L. 1280, No. 284), known as the 'Pennsylvania Securities Act of 1972,' or to regulation by the Pennsylvania Securities Commission."

<sup>16</sup>This section states that "[t]he Commissioner shall have authority to prescribe appropriate rules and regulations to carry out the purposes and provisions of sections 1301, 1329 and 1330 of this title." §1335 also states that "[t]he powers granted to the Securities Office of the Treasury Department under sections 851-895 of Title 10 known as Uniform Securities Act, with regard to the regulation and supervision of all the aspects of the variable annuities insofar as they are securities, shall in no wise [sic] be affected upon the taking effect of this section and sections 1329—1334 of this title. These securities, the variable annuities, shall continue under the coverage of the Securities Act and the regulations approved under said statute."

<sup>17</sup> Only fixed insurance, endowment and annuity contracts are excluded from the definition of security in Puerto Rico. [See, §881(l)].

<sup>18</sup> §7-11-101(22)(i) only fixed insurance, endowment and annuity contracts excluded, but §7-11-101(22)(i)(ii) excludes group *variable* contracts subject to ERISA

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<b>THE STATUS OF VARIABLE CONTRACTS UNDER STATE SECURITIES AND INSURANCE LAWS</b>			
<b>State</b>	<b>Statute Granting Insurance Commissioner Exclusive Jurisdiction to Regulate Variable Contracts</b>	<b>Complete Exclusion from State Securities Code for All Insurance, Endowment and Annuity Contracts. Occurs Through Exclusion from the Definition of "Security"</b>	<b>Other Parallel Exclusions from State Securities Code</b>
South Dakota	§58-28-31 <sup>19</sup>	<sup>20</sup>	
Tennessee	§56-3-508	§48-2-102(12)(E)	
Texas	Art. 3.75(8)	Art. 581-4(A)	
Utah	§31A-5-217.5(6)	§61-1-13(24)(b)	
Vermont	§3858	<sup>21</sup>	
Virginia		§13.1-501	
Washington	§13.1-501 <sup>22</sup>	§21.20.005(12)	
West Virginia	§33-13A-4	§32-4-401(a)	

<sup>19</sup> The provision granting the Insurance Commissioner exclusive jurisdiction to regulate variable contracts reflects the language of the NAIC Model Variable Contract Statute, but also contains two additional unique sentences stating that "The division of securities may, upon request by the director, review the underlying investments in securities of variable contracts. The division of securities may require filing a disclosure document with the division of securities pursuant to chapter 47-31A." *But see*, South Dakota Insurance Bulletin 93-2 (Revised December 17, 1993), which states that "Over the past year, the Division of Securities has reviewed the [variable] products for compliance with specific securities requirements. For the most part, the Division of Securities has found that the products meet its requirements and that nothing out of the ordinary is disclosed in the filings. In an attempt to conserve regulatory resources, the Division of Securities will no longer review variable products. The Division will continue to assert its jurisdiction over the variable agents, requiring registration as it always has, and will enforce the anti-fraud provisions of the law against violators."

<sup>20</sup> Only fixed insurance, endowment and annuity contracts are excluded from the definition of security in South Dakota. [*See*, §47-31A-401].

<sup>21</sup> No categories of any kind are excluded from the definition of security in Vermont. [*See*, §4202(a)(16)].

<sup>22</sup> Although granting the insurance commissioner sole authority to regulate the issuance and sale of variable contracts, the provision further states that the insurance commissioner shall not have jurisdiction "for the examination, issuance or renewal, suspension or revocation, of a security salesman's license issued to persons selling variable contracts. To carry out the purposes and provisions of this chapter he or she may independently, and in concert with the director of financial institutions, issue such reasonable rules and regulations as may be appropriate."

<b>THE STATUS OF VARIABLE CONTRACTS UNDER STATE SECURITIES AND INSURANCE LAWS</b>			
<b>State</b>	<b>Statute Granting Insurance Commissioner Exclusive Jurisdiction to Regulate Variable Contracts</b>	<b>Complete Exclusion from State Securities Code for All Insurance, Endowment and Annuity Contracts. Occurs Through Exclusion from the Definition of "Security"</b>	<b>Other Parallel Exclusions from State Securities Code</b>
Wisconsin	<sup>23</sup>	<sup>24</sup>	
Wyoming	§26-16-502(d)	§17-4-113(a)(xi)	

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<sup>23</sup> §611.24 of the Wisconsin Insurance Code grants the Insurance Commissioner significant authority to regulate variable contracts, but lacks reference to the insurance commissioner's "sole" or "exclusive" jurisdiction as contained in other insurance codes or the NAIC Model Variable Contract Statute.

<sup>24</sup> Only fixed insurance, endowment and annuity contracts are excluded from the definition of security in Wisconsin. [See, §551.02 (13)(b)].

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NUMERICAL SUMMARY OF VARIABLE CONTRACT STATUS CHART	
# of jurisdictions granting Insurance Commissioner <i>exclusive jurisdiction</i> to regulate the issuance and sale of variable annuities and variable life insurance contracts	47
# of jurisdictions excluding <i>all</i> insurance endowment and annuity contracts from the definition of "Security" in state securities code	35/37 <sup>25</sup>
# of jurisdictions <i>specifically</i> defining variable annuity and variable life insurance contracts as a "Security" in state securities code (i.e., these states have inserted the optional bracketed language "[a fixed sum of]" from § 401(l) of the USA of 1956.	8 <sup>26</sup>
# of jurisdictions excluding <i>no</i> categories of any kind from the definition of "Security" in state securities code	4 <sup>27</sup>
# of jurisdictions having <i>no</i> exclusion from the definition of "Security" for <i>any</i> type of insurance, endowment or annuity contract (i.e., fixed <i>and</i> variable insurance, endowment or annuity contracts are defined to be securities).	2 <sup>28</sup>

<sup>25</sup>The total of 37 could be used for this category, but needs explanation because in two states the definitional exclusions do not include *all* variable insurance, endowment or annuity contracts .

- The definition of "security" in Alabama includes "annuity contract **unless** issued by an insurance company." [See, §8-6-2(10)]. Variable annuities issued by a life insurance company, therefore, are excluded from the definition of security in Alabama.
- The Georgia statute refers only to variable *annuities* in the exclusion from the definition of security. Therefore, variable life insurance contracts are technically not within the exclusion, although exclusion of both variable annuities and variable life insurance contracts was probably intended by legislature. [See, §10-5-2(26)].

<sup>26</sup> These states are: DC, KY, LA, MT, NV, PR, RI and WI. There is a qualification to one state in this category. RI excludes from the definition of security *group* variable contracts subject to ERISA.

<sup>27</sup> These states are: AZ, ND, OH, and VT.

<sup>28</sup> These states are: IL and NM.



**TESTIMONY**  
Regarding House Bill 2243  
Committee on Financial Institutions  
Rep. Ray Cox, Chairman

Rick Friedstrom, CLU  
Kansas Association of Insurance and Financial Advisors  
February 12, 2001

Chairman Cox, Members of the Committee. Good Afternoon. I am Rick Friedstrom. I speak before you representing the Kansas Association of Insurance and Financial Advisors (KAIFA). Our 1500 members sell and service a wide range of insurance products to the Kansas insurance consumer. Our Association has worked closely with the Kansas Insurance Department since August 1935 on legislation and regulation that does benefit the Kansas insurance consumer.

I speak with you today regarding HB 2243 to oppose its passage. Our Association stood before your Committee during last Session to oppose similar proposed legislation. We feel neither the Kansas insurance agent nor the Kansas insurance consumer will benefit from the additional layer of regulation discussed in this bill.

Currently, the Kansas Insurance Department regulates the Kansas insurance agent. During the past 20 years many insurance companies have introduced "variable" products in response to consumer demands. These new "variable" life insurance and "variable" annuity products afford the consumer additional choice in determining the appropriate product to fill their unique insurance situation.

The Agent who desires to sell a "variable" product enters into a whole new regulatory arena in order to offer these products to the public. Before an agent can even discuss these products with a prospect, the agent has to pass a very comprehensive examination in order to be registered by the National Association of Securities Dealers (NASD) as a Registered Representative.

By agreeing to be regulated by the NASD, the Registered Representative agrees to a code of conduct that is national in scope. Registered Representatives follow strict educational and ethical guidelines. If the Registered Representative does not adhere to these guidelines, the individual could potentially have their registration revoked which would prevent them from selling “variable” products anywhere in the United States, not just Kansas.

The Kansas insurance agent who is also a Registered Representative is regulated quite heavily, already:

The Kansas Insurance Department enforces insurance issues most effectively.

The Securities and Exchange Commission provide significant enforcement authority over Registered Representatives.

The National Association of Securities Dealers regulates the conduct of the Registered Representative most carefully.

We of the Kansas Association of Insurance and Financial Advisors do not see a clear and compelling reason for passage of this proposed legislation and urge your vote in opposition to HB 2243.

Thank you.

Rick Friedstrom  
2916 West 20<sup>th</sup>  
Topeka, Kansas 66604

**Testimony on House Bill 2243**  
**Before the House Financial Institutions Committee**  
**By Larry Magill**  
**Kansas Association of Insurance Agents**  
**February 12, 2001**

Thank you Mister Chairman and members of the Committee for the opportunity to appear today as an opponent of the variable life and annuity provisions of H.B. 2243. These provisions are found in Section 11 of the bill on page 23.

**Substantially Greater Change Than What Appears**

The substantive changes, for us, are found on pages 25-26 and would split the current state regulation of variable life and annuity contracts between the Kansas Insurance Department and the Kansas Securities Commissioner. The department would retain authority over terms and provisions of the policies and the Securities Commissioner would assume authority over all else including licensing. It is difficult to tell the exact extent of the change since the bill simply eliminates the current carve-out under Kansas Securities laws for variable life and annuity products. With all of article 12 of chapter 17 now applying to these products for the first time, it is likely that the changes are very extensive.

**Yet Another License**

This would add yet another license for my members to obtain in addition to their life and health license, their series 6 and 63 NASD (National Association of Securities Dealers) licenses and now a Kansas Securities license. It would add an additional department of state government to deal with and the complexity of an entirely separate regulatory scheme to understand. Most of our members would only be selling mutual fund type products and would probably not be involved in individual securities sales or other types of investments. If they are involved in offering products other than variable life and annuities, they would need the proper securities licenses.

**Not Functional Regulation**

We are not swayed by the arguments made by the Securities Commissioner that this is simply carrying out the functional regulation called for by Gramm-Leach-Bliley. This is actually exactly what GLBA sought to avoid, the multiple jurisdiction and multiple regulation of people within the financial industry. Where currently you have only one regulator with jurisdiction over variable life and annuity products in Kansas, the Insurance Commissioner, HB 2243 would add a second layer of regulation that is unnecessary.

**No "Problem" to Fix**

We are unaware of abuses of the current system that this bill would address. If there is a fear that convicted felons would simply switch from selling securities, once they lose their securities license, to selling variable products, the Federal Violent Crime Control and Law Enforcement Act of 1994 would apply. That act makes it illegal for anyone to

engage in the business of insurance after being convicted of a felony involving a breach of trust or dishonesty.

If the Committee decides to work the rest of the bill, we urge you to strike Section 11 from the act. Thank you for the opportunity to appear today. We would be happy to answer questions or provide whatever additional information the committee might need.

**House Committee on Financial Institutions**

**Testimony of Amy Lee, Vice President and Associate General Counsel of  
Security Benefit Life Insurance Company**

**House Bill No. 2243**

**February 12, 2001**

Security Benefit Life Insurance Company ("Security Benefit") is a Kansas life insurance company located in Topeka, Kansas with approximately \$10 billion in assets under management. Security Benefit offers fixed and variable annuities, money management services, retirement plans and, through its subsidiary broker/dealer, Security Distributors, Inc., a family of mutual funds.

Security Benefit would like to comment on House Bill No. 2243, which would provide for the insurance commissioner and securities commissioner to share jurisdiction with regard to the issuance and sale of variable insurance products. Under current law, the insurance commissioner has *sole and exclusive* jurisdiction and authority to regulate insurance products, including variable insurance products. Current law explicitly states that insurance contracts, the companies that issue them, and the agents who sell them shall not be subject to the securities laws of Kansas or to the jurisdiction of the securities commissioner. We believe that such sole and exclusive jurisdiction is appropriate and should not be changed for the reasons discussed below.



I have worked at Security Benefit as an attorney for 14 years. During that time my emphasis has been on developing variable insurance products and variable insurance products compliance. The long-standing regulatory structure, which dates to the creation of variable annuity products in the 1960s, is regulation of the products as insurance at the state level and as securities at the federal level. It has been my experience that this approach has worked well and that there is no compelling reason to upset this structure. Before discussing the bill, I would like to give a brief overview of the current regulatory structure.

The variable annuity industry is extensively regulated at both the state and federal level as set forth below.

- New insurance products are filed with the insurance departments of the 50 states for review and approval prior to sale
- A registration statement must be filed and effective with the Securities and Exchange Commission ("SEC") prior to sale of the product
- Individuals who sell the products are insurance licensed in those states in which they do business and must be appointed agents of one or more insurance companies
- Such individuals are also registered with the National Association of Securities Dealers, Inc. ("NASD"), a federal self-regulatory organization

- Each such individual must be registered with a broker/dealer that is a member of the NASD and also registered with the SEC
- Under NASD Conduct rules, any securities transaction recommended must be “suitable” with regard to the customer’s financial situation and needs

In addition to NASD suitability requirements, the insurance commissioner may revoke an agent’s license under the following circumstances<sup>1</sup>:

- License was obtained by fraud or misrepresentation
- Agent misrepresented the provisions of an insurance or annuity contract
- Agent engaged in rebating or any inducement not contained in the insurance contract
- Agent intentionally omitted a material fact
- Agent made misleading representations or incomplete comparisons for the purpose of inducing a surrender of in-force insurance
- Agent has been convicted of a misdemeanor or felony involving fraud, deceit dishonesty, intent to defraud or intent to deprive
- Agent’s license does not serve the interests of the insurer or the insurable interests of the public

As part of my duties at Security Benefit, I review all customer complaints received and over my 14-year tenure, I have not seen any serious problems. Most complaints that we receive are related to administrative problems that have

not been resolved to the customer's satisfaction and are not related to the agent's activities. With regard to more serious complaints, for example, allegations that an agent did not fully explain the risk of investing in a variable product, these complaints typically have been received by the relevant state insurance department and are resolved satisfactorily by the insurer, the agent and the insurance department. It is worth noting that Security Benefit does not have a captive agency force but sells its insurance products through independent agents. As a result, our agents are a representative sample of agents doing business in Kansas.

Although we do not see compelling reasons for an additional regulator, we do believe that shared regulation of the issuance and sale of variable insurance products by the insurance and securities commissioners presents potential problems, as follows:

- Potential for conflicting positions taken by the two regulators
- Difficulties in regulating the agents, without also regulating the principals, i.e., the insurance companies
- A regulatory framework that is inconsistent with the majority of other states
- Regulation of insurance products by a secondary regulator without insurance expertise
- Unnecessary additional regulation

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<sup>1</sup> K.S.A. 40-242.

In conclusion, we ask that you consider whether a change in a long-standing regulatory structure is justified, taking into account the following:

- Variable annuity industry is currently regulated by the state insurance departments, SEC and NASD
- The Insurance Commissioner is the long-standing functional regulator of insurance products
- Current regulatory structure has sufficient tools to address bad conduct on the part of industry participants
- Additional regulation imposes a burden on business with very little, if any, incremental protection of the public

I appreciate the opportunity to share our views on this bill with you. We would be happy to address any questions that you may have.