Approved: April 30, 2003
Date

MINUTES OF THE HOUSE JUDICIARY COMMITTEE.

The meeting was called to order by Chairman Michael R. O'Neal at 3:30 p.m. on February 19, 2003 in Room 313-S of the Capitol.

All members were present except:
Representative Dale Swenson - Excused
Representative Dan Williams - Excused

Committee staff present:
Jerry Ann Donaldson, Legislative Research Department
Jill Wolters, Revisor of Statutes
Cindy O'Neal, Committee Secretary

Conferees appearing before the committee:
Representative David Huff
Candy Shively, Deputy Secretary, Kansas Department of Social and Rehabilitation Services
Glen Quackenbusch, Lenexa
Woody Moses, Kansas Ready-Mixed Concrete Association
Trista Curzydlo, Kansas Bar Association
David Brant, Kansas Security Commissioner
Tim Plumlee, Ulysses
Glenn Bishop, St. Marys
Ronald Rumsey, Topeka
John McCabe, Uniform Law Commission
Carl Wilkerson, Association of Life Insurance Companies

The hearing on **HB 2331 - back child support owed does not go dormant**, was opened.

Representative David Huff requested the bill for a constituent. Parents who do not pay child support places the pressure of raising children on the other parent. The proposed bill would make the non payment of child support obligation be paid to the parent, and upon death of the custodial parent the remaining child support owed would go to the surviving children. The only way a child support obligation would stop is through the death of the parent which owes the child support or if the child support is paid off.

Representative Huff provided a letter from Della Smith who's ex-husband owes back child support (Attachment 1).

Candy Shively, Deputy Secretary, Kansas Department of Social and Rehabilitation Services, believes that the proposed bill was good public policy. Many states are moving towards this direction. (Attachment 2)

The hearing on **HB 2331** was closed.

The hearing on **HB 2215 - increasing claim limit in small claims court from $1,800 to $5,000**, was opened.

Representative David Huff requested the proposed bill which would raise the limit for filing a suit in small claims court. The amount has not been raised since 1994 and items that cost $1,800 have tripled since that time. (Attachment 3)

Glen Quackenbusch, Lenexa, told the committee of his situation with Crestline Windows & Doors and not being able to file in small claims court. (Attachment 4)

Woody Moses, Kansas Ready-Mixed Concrete Association, appeared before the committee in support of the proposed bill because it would enable producers to resolve a number of claims without having to secure the services of a lawyer; would reduce the filings in the limited action divisions and would track with inflation increases since 1994. (Attachment 5)

Trista Curzydlo, Kansas Bar Association, appeared before the committee as an opponent of the bill. She

stated that this encourage the unauthorized practice of law. (Attachment 6)

The hearing on **HB 2215** was closed.

The hearing on **HB 2347 - Uniform Securities Act**, was opened.

David Brant, Kansas Security Commissioner, reminded the committee that Kansas has one of the best securities acts in the country, however, with the passage of the proposed bill it will be an even better act. While the proposed uniform bill has many provisions, Mr. Brant touched only on the issue of variable annuities was included in the bill. (Attachment 7)

Tim Plumlee, Ulysses, Glenn Bishop, St. Marys and Ronald Rumsey, Topeka, all spoke of instances where they invested in variable annuities and lost a large amount of their savings due to not understanding how an annuity works and not understanding the contract that they signed. (Their testimony can be found in attachment 7)

John McCabe, Uniform Law Commission, informed the committee that the ULC undertook the writing of the securities act to coordinate federal and state securities regulations. (Attachment 8) The Act touches on the following main issues:

- Registration of securities
- Regulation of broker-dealers, investment advisors, their agents and representatives
- Expanded enforcement powers
- Investigatory and subpoena powers
- Criminal penalties set by statute
- Investor education
- Electronic filing facilitation

The Act makes it optional whether to include variable annuities in the definition of security or to exclude it from that definition. He suggested that variable annuities are viewed as a security and probably should be regulated as one. (Attachment 9)

Carl Wilkerson, Association of Life Insurance Companies, appeared in support of the original Uniform Securities Act, without the variable annuities provision. The proposed bill, as drafted, would add to the costs of doing business in Kansas and would injure consumers by discouraging competitors to operate in Kansas. (Attachment 10)

The Kansas Bankers Association requested an amendment on page two, line 10 to include the words "or trust company" (Attachment 11).

The Chairman announced that the hearing on **HB 2347** would remain opened and would continue at a later date.

February 19, 2003

Thank you Judicial committee for accepting my written testimony on H:B 2331.

I am sorry I cannot be at your committee meeting today but I could not be off work. I am a divorced single mother of 10 years. I have one son who I have dedicated my life to. I struggle to make sure my son has a well rounded life. He makes very good grades and I make sure he has the money to participate in sports and all school activities. My only assets are my son and my home which I bought after my divorce.

My son is 12 years old. My ex-husband owes in back child support over $20,000. He has made no attempt to pay support for several months and has paid off and on for years. I for-see his back support obligation to be over $40,000 when my son reaches 18. I am sure he will go on to college if my health and age hold out for the payments.

My Huff's bill will at least make it possible that some day I might collect some child support or even my son could collect as we have struggled to live a decent life. I fear that as my son reaches 18 or 21, I might forget to file court papers to continue to obligate my ex-husband to pay his back child support which I know he will owe.

Thank you very much

Della Smith

H. JUDICIARY
2-19-03
Attachment: 1

Candy Shively

Kansas Department of Social and Rehabilitation Services
Janet Schalansky, Secretary

House Judiciary Committee
Wednesday, February 19, 2003

H.B. 2331: Child support and dormancy

Mr. Chairman and members of the committee, I am pleased to appear before you today to speak in support of HB 2331.

Protecting unpaid installments of child support from the effects of dormancy is good public policy. Several states, including our neighbor Oklahoma, already have reached that conclusion and have enacted measures similar to the bill before you.

The primary purpose of dormancy is to clear the title to real estate whenever a judgment lien is no longer needed by the creditor. By its nature, however, an order for child support does not fit the mold of a typical money judgment. Current support orders normally run more than five years. It simply does not make sense for support orders older than five years to become dormant while new installments of child support for the same order are still accruing.

Rarely do custodial parents truly abandon an order for child support —they may become discouraged and wonder if it will ever be collected, but they rarely abandon their children's claims completely. This bill insures that custodial parents and public offices alike will have the maximum opportunity to collect unpaid child support without incurring expenses that are unnecessary to demonstrate their interest in collecting the unpaid installments.

Existing law compels the Child Support Enforcement program to incur expense for renewal affidavits to protect the enforceability of past due child support. This bill is expected to save CSE $10,000 per year (all funds) by eliminating the need to print, mail, and file with the court clerks more than 13,000 renewal affidavits annually.

Every year CSE must forego as much as $100,000 in child support collections because dormancy and related laws have made Kansas child support judgments unenforceable. The lion's share of that money would have gone to families who could have used it to pay off debts, save for college, or otherwise invest in their children's future. Please help us to help these families.

I encourage you to support House Bill 2331.

H. JUDICIARY
2.19.03
Attachment: 2

STATE OF KANSAS

DAVID HUFF
REPRESENTATIVE, 30TH DISTRICT
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LENEXA, KANSAS 66215
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TOPEKA

HOUSE OF
REPRESENTATIVES

COMMITTEE ASSIGNMENTS
VICE-CHAIR: TAX
MEMBER: ETHICS AND ELECTIONS
INSURANCE
KANSAS FUTURES

February 17, 2003

Re: House HB 2215-Small Claims

Thank you chairman O'Neal, Vice chair Patterson, Ranking minority Pauls and fellow legislators:

Small claim courts are designed as a efficient and less expensive way to come before a judge and plead your case.

House Bill 2215 does one simple thing. This bill would change the maximum amount that a person can file and go to small claims court. The current maximum is $1,800 which was last changed in 1994. Small items that were in the $1,800 range in 94' have tripled in cost. This would bring the maximum in line with today's cost and raise the total to $5,000.

Representative David Huff

H. JUDICIARY
2-19-03
Attachment: 3

Kansas Judiciary Committee
Topeka, Kansas

My name is Glen Quackenbush and I am here today to ask that you support the House Bill that raises the maximum dollar limit in Small Claims Court from the current $1,800 to $5,000. In support of this request I am going to tell you about my conflict with Crestline Windows & Doors which is part of a large national manufacturer headquartered in Wisconsin. Due to time limitations this will be an admittedly simplistic assessment.

There is no dispute that last year we were sold some Crestline windows and doors that had hidden defects. Specifically the defects were improperly glued veneer that in some cases separated from the base wood and vision obstructions sealed between the double panes of glass. The veneer defect did not appear until after the wood was finished, and the visual defects were not apparent until after the windows were washed. We thought it unreasonable to expect us to wash the windows prior to installation or staining. Sherry and I brought it to their attention shortly after installation and their offer was to repair or replace but, per their warranty, not to pay the considerable cost of installation or the necessary refinishing of the wood interiors. These costs easily exceeded the current limit of $1,800 available in Small Claims Court. I attempted to tell various people at Crestline Windows & Doors that Kansas law over ruled their warranty because the defects could not reasonably be discovered prior to installation or finishing, and due to their negligence, we should be made whole. Their response was to send numerous copies of their warranty which had never been presented or available until after the problem.

Sherry and I consulted a lawyer who specializes in consumer cases. She told us that we were correct in that the warranty was not enforceable in this situation and that she strongly believed that a court would rule in our favor. She pointed out that her rate of $150 per hour would cost us more than the damages. She further commented that ethically challenged companies know that most consumers can not afford to take them to court and that is why they stonewall the consumer.

The point I am trying to make is there is a large gap between the current $1,800 maximum award that a Kansas citizen can get from Small Claims Court and the minimum dollar amount that would interest or justify legal representation. Raising the Small Claims Court limit to $5,000 or even $10,000 would not eliminate this gap, but I bet it would make some "ethically challenged" companies think twice before they ignore the law. I understand it would also bring Kansas more in line with some other consumer-conscience states.

Glen & Sherry Quackenbush
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Lenexa, Kansas 66215
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913-888-9454

H. JUDICIARY
2. 19. 03
Attachment: 4

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KRMCA

Kansas Ready Mixed
Concrete Association

KAPA

Kansas Aggregate
Producers' Association

TESTIMONY

By the
Kansas Aggregate Producers' Association
Kansas Ready Mixed Concrete Association

Before the
House Committee on Judiciary

Regarding HB 2215

February 19, 2003

Mr. Chairman and members of the committee, my name is Woody Moses, Managing Director of the Kansas Aggregate Producers' Association, and the Kansas Ready Mixed Concrete Association. Thank you for the opportunity to provide testimony on HB 2215. The Kansas Aggregate Producers' Association (KAPA) and The Kansas Ready Mixed Concrete Association (KRMCA) are statewide trade association comprised of over 250 members and one of the few industries to be represented in every county of this state.

If enacted HB 2215 would raise the claim or value amount in small claims actions from the current $1,800 to $5,000, allowing small business owners greater flexibility in the filing of small claims. The current $1,800 limit has been in effect since 1994. We believe all Kansans would be better served by raising the current $1,800 to $5,000 for the following reasons:

- Enable producers to resolve a greater number of claims without having to secure the services of a lawyer or go to the expense of a formal trial.
- Reduce filing of suits either in the limited actions division, or the District Court. Relieving the workload in these areas.
- Allow the limit to track inflation increases since 1994 and provide some room to grow.

Since its inception in 1973, the Kansas Small Claims Act has become a valuable legal service, allowing many Kansans greater access to their judicial system. Please join us in making this an even better system by recommending HB 2215 favorable passage.

Thank you for receiving our comments on HB 2215, I will be happy to respond to any questions you may have at this time.

H. JUDICIARY
2-19-03
Attachment: 5

KANSAS BAR ASSOCIATION

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FAX (785) 234-3813
www.ksbar.org

February 19,2003

TO: Chairman O'Neal and Members of the House Judiciary Committee

FROM: Trista Beadles Curzydlo, KBA Lobbyist

RE: House Bill 2215

Chairman O'Neal and Members of the Committee:

My name is Trista Beadles-Curzydlo and I am here today representing the Kansas Bar Association. The KBA is a diverse organization with more than 6,000 members, including judges, prosecutors, plaintiffs' attorneys, defense attorneys, and many others.

The KBA opposes the adoption of House Bill 2215 regarding the expansion of small claims jurisdiction to disputes concerning $5,000. House Bill 2215 would allow for inequities to develop in the administration of justice and encourages the unauthorized practice of law.

In 1973 when the small claims act was enacted, plaintiffs were allowed to bring no more than five actions per year and no dispute could exceed $500 in value. In 1986 the small claims act was amended to allow actions not exceeding $1,000 in value and no more than ten actions per year to be brought by one plaintiff. In 2002 the small claims act was amended once again to increase the limit of the claim to $1,800.

The intention of the small claims act was that all parties were on all equal footing in an inexpensive forum where parties received a swift trial to resolve minor civil matters. Attorneys were not allowed to represent individuals in this forum where the fees of the attorney may very well exceed the judgment of the court. The KBA is concerned that HB 2215 will not only allow, but encourage, corporations and businesses to bring collections actions in small claims courts. This will create a situation where a defendant not represented by law-trained counsel may potentially find himself opposing employee–attorneys of a corporation. To expand the jurisdiction of the small claims court and allow for this gross inequity to occur is counter to the very concept of the small claims act.

Corporations can only be represented in Kansas courts by an attorney licensed to practice in Kansas. A corporation is an artificial entity that is without the right of self-representation, for a non-attorney employee to represent a corporation in small claims court is the unauthorized practice of law. The KBA is opposed to any legislation that encourages the unauthorized practice of law.

I thank you for your consideration of this issue and welcome any questions that you may have.

H. JUDICIARY
2-19-03
Attachment: 6

TESTIMONY IN SUPPORT OF HOUSE BILL No. 2347
Kansas Uniform Securities Act
Judiciary Committee Kansas House

DAVID BRANT
Securities Commissioner
February 19, 2003

Mr. Chairman and members of the committee, thank you for this opportunity to testify in support of House Bill No. 2347 which would adopt the Kansas Uniform Securities Act. I have also provided for your consideration a notebook of various materials and a spreadsheet analysis.

I would like to remind you about my background. I am finishing my seventh year as the Securities Commissioner. Prior to my appointment by Governor Graves, I worked for twelve years in the securities industry as an underwriter and advisor on municipal bond issues for cities and counties across Kansas. I also was licensed as a registered representative and I handled a small number of stock transactions in the early years of my career. I am also a licensed attorney.

My securities industry experience has been very helpful as it provides important perspective in my work as the Securities Commissioner. As a regulator, we constantly must consider the balance between consumer protection and reasonable regulation. What is reasonable to expect from the regulated industry in order to protect consumers? Since I've worked in the securities industry... and since I expect to return to the private sector... I believe that I have a balanced perspective. What's reasonable will be discussed today as we ask you to consider whether to totally rewrite our state's securities laws.

Kansas' Leadership

Kansas has been and will continue to be a leader in securities regulation and in the protection of our citizens. It is because of Kansas' leadership and because we might be one of the first states to adopt this act... that the securities and insurance industries are most interested, and most willing to fight for amendments, in House Bill 2347. Enclosed for your historical interest behind Tab 2 is a 1911 article from *The Saturday Evening Post* which describes Kansas' leadership in adopting and implementing the first "blue sky" law.

Currently, Kansas has one of the best securities acts in the country – we already have important consumer protections and enforcement tools. In addition, the office of Kansas Securities Commissioner has an outstanding staff and we are a national leader among states in the number of administrative actions and criminal convictions on a per capita basis. If our current laws or the actions of our agency were a burden on the financial services industry... you would have heard about it.

H. JUDICIARY
2-19-03
Attachment: 7

Support for Uniformity

We also have been progressive in working with other states to promote uniformity. In regard to this proposed uniform act, I want you to know that I have met with the Drafting Reporter on a number of occasions. I have the highest respect for Joel Seligman. He is one of the leading securities law experts in the country… and in his spare time he is the Dean of the Washington University law school in St. Louis.

I commend Dean Seligman and the NCCUSL Drafting Committee for their hard work to build consensus between regulators, the securities industry, and attorneys and to draft a uniform act for the 21st century which preserves a number of important investor protections.

As the Securities Commissioner, I will tell you, in my opinion, that we don't need this uniform act in order to protect Kansas investors… because through our enforcement of our current laws… we are already doing a good job. This is in contrast to the laws of other states, such as Missouri… where my colleague will tell you that this uniform act will strengthen Missouri's ability to protect their citizens.

To assist in an analysis of our current laws compared to the Uniform Securities Act, my General Counsel, Rick Fleming, has compiled a spreadsheet with five columns. This side-by-side listing allows you to compare the "how" and the "why" of the differences with the fifth column showing the actual text of House Bill 2347.

I am here today to support House Bill 2347, with a number of amendments that we are currently discussing, in order to promote uniformity provided that we preserve some investor protections and enforcement tools from our current Kansas law. However, let me be clear, I am unwilling to sacrifice important investor protections just for the sake of uniformity. Thus, my support of the bill will depend on the amendments which are ultimately adopted.

Changes to current Kansas law

In general, House Bill 2347 does not propose any "new" regulatory powers except for the functional regulation of agents selling variable annuities. But in addition to preserving important provisions in Kansas law, the bill does contain the following two items that would constitute a change in current law.

1. Cap on Agent Fees

Under current law, the cap on the annual registration fee in Kansas for brokers and investment advisers is $50. In section 27, it is proposed that this cap on agent fees be raised to $100, though we are not proposing a fee increase at this time. Fees are set by regulation after publication and public comment. The reason for the cap to be raised in House Bill 2347 is so that future fee increases, if needed, would not require further legislation. Any fee change by regulation will be subject to legislative oversight through the Rules and Regulation committee.

2. Tougher Securities Penalties

Behind Tab 4, there is an outline of the proposed harsher criminal and administrative penalties for securities fraud and other violations which have been incorporated in House Bill 2347. In addition, we are proposing two new laws which are modeled after similar provisions in the Sarbanes-Oxley Act: 1) section 34(b) on page 44 would make it a crime to influence or mislead

an appraiser or an auditor in the preparation of appraisals or financial statements; and 2) section 34 (c) would prohibit the destruction or falsifying of records and would protect whistleblowers from retaliation for providing truthful information.

Non-Uniform Provisions

Our support for uniformity is not without some limits. Unfortunately, I don't have time to walk through every provision in which we have proposed a change from the uniform language, but I would like to highlight two areas that are critically important to our ability to protect investors.

1. Enforcement Authority and Sanctions

The new uniform act should promote uniformity with respect to the rules that people are expected to obey (which can be referred to as "front-end" regulation), but it should not demand uniformity with respect to the sanctions for violating those rules (which can be referred to as "back-end" regulation). Matters of enforcement authority and sanctions should be left to the various states. In particular, states should be free to insert additional sanctions within sections 29 and 43 as they see fit (USA sections 412 and 604).

In Kansas, we currently have the authority to enter cease and desists orders against registered firms and agents, as well as ordering them to disgorge ill-gotten gains or pay restitution. Those sanctions should be included in section 29 (USA section 412). Likewise, we have to authority to order disgorgement or restitution, as well as bars from the industry, against non-registrants, so those sanctions have been added in section 43 (USA section 604).

2. Sales from Kansas to out-of-state investors

House Bill 2347 does not contain USA subsection 202(20) which would allow an in-state person or firm selling securities to out-of-state residents to be exempt from registration in Kansas as long as the sales do not violate the laws of the state in which each investor is present. Likewise, the securities themselves would not have to be registered with Kansas in these types of interstate transactions.

We do not support this provision because it puts the burden on the regulator to determine whether an offering complies with laws in other jurisdictions, including foreign countries. But even worse, it flies in the face of coordinated, efficient securities regulation by removing our ability to "clean up our own backyard." If an unscrupulous brokerage firm is victimizing its customers, it is much more efficient for the home state to take action instead of relying on another state to police a company outside its jurisdiction.

Furthermore, we regularly take action against unregistered in-state promoters who sell fraudulent investments exclusively to out-of-state investors, and USA 202(20) would limit our ability to take action against those schemes. We would still have anti-fraud authority under 202(20), but it would strip away our ability to freeze assets, conducts search warrants, etc., based upon registration violations. Generally, by the time we can prove a fraud case, the money is already gone, so registration violations are critical weapons in our arsenal against fraud.

Because USA 202(20) would allow unscrupulous promoters to set up shop in Kansas as long as they are careful to sell out-of-state, it should not be adopted in Kansas. The threat to our agency's enforcement authority is real, not theoretical, as illustrated by several administrative cases and at least two of our criminal conviction within the past year. These cases would have been negatively impacted by the exemption contained in USA 202(20):

- Dawn Glassburn-Hoesli is a Salina woman who stole $250,000 from a California man. She was convicted of several counts of selling securities without a license and selling unregistered securities, along with securities fraud and theft.

- Philip McGuckin is now a Wichita resident who previously operated an oil and gas Ponzi scheme, out of Goodland, in which 53 investors lost in excess of $1 million. All of the investors were out-of-state, but we successfully prosecuted McGuckin in Kansas, based in large part on our ability to obtain a search warrant and seize evidence. As a practical matter, no other state would have sought a search warrant against this Kansas company, so it is unlikely that another state would have successfully prosecuted McGuckin.

Thus, these cases demonstrate our concerns about USA 202(20) which is why we recommended that this uniform provision not be included in House Bill 2347.

Variable annuities

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 is a life insurance contract which provides future payments, the amount of which depends on the performance of the subaccount's mutual funds or other securities.

I am not here to criticize the variable annuity product or the insurance industry or its agents. My thanks to the Governor and the Legislature --- since 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.

Variable annuities should no longer be excluded from the definition of "security". Thus, in section 2, definition (28) on page 7, the exclusion for insurance product only applies to fixed and not to variable annuities.

Kansas law should be consistent since Variable Products are "securities" under Federal Law

On July 29, 2002, the National Conference of Commissioners on Uniform State Laws (NCCUSL) adopted the new Uniform Securities Act under which variable products **can be** defined as securities, while exempting such products from state securities registration requirements. The goal of the USA Drafting Committee and NASAA is to provide for functional regulation of agents selling variable products… since variable annuities and variable life insurance are hybrid products that are marketed to the public as investments. Variable insurance products have been considered securities under federal law ever since a 1959 U.S. Supreme Court decision.

Washington and Arizona adopted Functional Regulation in 2002

The states of Washington and Arizona both adopted functional regulation in 2002. There are now eight jurisdictions which have adopted the proposed USA definition without the bracketed words (DC, KY, MT, NV, PR, RI, SD, and WA). In addition, the state of Hawaii regards variable annuities as securities but does exclude variable life insurance. And lastly, an additional eight states have no exclusion of any kind from their definition of security (AZ, FL, IL, ND, NM, NY, OH, and VT). The state of Arizona's new law clarifies that agents selling variable products need to also have a state securities license.

Regulation of the Products and Insurance Companies will NOT be affected

Even if the new Uniform Securities Act is adopted, the regulation of insurance companies will remain exclusively with state insurance regulators. Registration and regulation of variable products will remain with the Securities and Exchange Commission (SEC) and with state insurance regulators.

Most Agents are already dually licensed

Most agents selling variable products are also licensed to sell mutual funds and other investment products. This was confirmed in a December 2001 review which shows that 93% of Kansas agents (4,778 of 5,143 with variable insurance licenses) also have a state securities license.

Legislative Decision may be dictated by Politics rather than by What's Reasonable

As so often happens, this may come down to a struggle between what's reasonable and raw political power. Investors in variable products and in mutual funds both deserve the same quality of state protection in the regulation of agents selling these virtually identical forms of investments --- not a disjointed structure devised 35 years ago. Times and markets have changed... and financial modernization dictates that state regulatory laws, should be modified to cope with the 21st Century.

Thank you for your consideration and we will be glad to answer any questions.

The inordinate birth rate of the "sucker" is proverbial, and there is no birth-control measure adequate to inhibit the spawning of unscrupulous individuals who prey upon those who are easily duped. Hence we have a blue sky law.

Justice Rosseau A. Burch
Supreme Court of Kansas
November 5, 1932
Moos v. Landowners' Oil Ass'n et al.
136 Kan. 424

House Bill No. 2347

BANKS and the KANSAS UNIFORM SECURITIES ACT

Since the repeal of Glass-Steagall by the Gramm-Leach-Bliley Act (GLB) in 1999, banks may enter the business of buying and selling securities for investors as broker-dealers subject to federal securities regulation. A bank may avoid registration as a broker or dealer at the federal level if the bank limits its activities to those specified in Sections 3(a)(4) and (5) of the Securities Exchange Act of 1934 as amended.

In Section 102(4), the new Uniform Securities Act (USA) conforms the state securities definition of "broker-dealer" to federal law and includes banks in the definition of broker-dealer where investor protection concerns apply. The USA generally adopts the GLB activity focused exceptions for banks with two minor modifications (see attached outline) relating to the private placement and de minimis brokerage activities of banks (15 U.S.C. 87c(a)(4)(B)(vii) and (xi)).

The Uniform Securities Act is an up-to-date securities statute designed to effectively protect investors and provide a fair regulatory framework for the financial services industry. Investors deserve these appropriate protections whenever, wherever, and with whomever they invest.

- Many banks already have separate broker-dealer subsidiaries that are registered and regulated as such. Those banks that do not have such regulated subsidiaries should, to the extent they act as broker-dealers, be subject to the same registration and qualification requirements as other broker-dealers.

- Allowing banks special limited offering exemptions that are not available to all other broker-dealers is of serious concern to regulators because there is the potential for significant disclosure and fraud problems in some private placement offerings.

- Banks will still be allowed to make up to 500 unsolicited "accommodation" trades in securities for their customers (as long as the transactions are not conducted by bank employees who are also employees of a broker-dealer).

- In Section 102(4)(E), the Securities Commissioner is given the authority to grant additional exclusions from the definition of broker-dealer by regulation.

- The proposed effective date of the Kansas Uniform Securities Act is July 1, 2004.

BANKING ACTIVITIES EXEMPT FROM SECURITIES REGULATION

"Push-Out" Exemptions available under

Gramm-Leach-Bliley (GLB) as compared to the **Uniform Securities Act (USA)**

3(a)(4)(B)	GLB	USA	
(i)	Y	Y	**"Networking" or third party brokerage.** Exempts certain support services provided by bank employees to third party brokers in connection with securities sales to bank customers.
(ii)	Y	Y	**Trust and fiduciary brokerage and dealing.** Generally exempts transactions provided in a bank's trust or fiduciary capacity, subject to restrictions on advertising and limits on some types of fee arrangements.
(iii)	Y	Y	**Permissible Securities.** Exempts transactions in bank eligible securities such as commercial paper and exempted securities.
(iv)	Y	Y	**Stock purchase plans.** Generally exempts transactions that a bank effects as stock transfer agent for employee benefit plans, dividend reinvestment plans, and "issuer" plans, if the bank does not solicit transactions or provide investment advice.
(v)	Y	Y	**"Sweep" accounts.** Exempts "sweep account" transactions for no-load money market mutual funds.
(vi)	Y	Y	**Affiliate transactions.** Exempts brokerage for any of a bank's affiliates, unless the affiliate is a broker-dealer or is engaged in merchant banking.
(vii)	Y	(N)	**Certain private placement offerings. Exempts a bank's private placement activities as agent if the bank is *not* affiliated with a broker-dealer that engages in underwriting or dealing in bank ineligible securities.**
(viii)	Y	Y	**Safekeeping and custody brokerage.** Generally exempts such customary bank activities as general safekeeping and custody, securities clearing and settling, securities lending and borrowing, securities pledging, and custodial or administrative services for individual retirement accounts and other employee benefit plans.
(ix)	Y	Y	**Identified banking products.** Exempts transactions involving the following specific banking products, in order to prevent their being characterized as "securities" subject to push-out: ***deposits; bankers acceptances; bank letters of credit; bank loans; loan participations*** provided to "qualified investors" (and in some circumstances to other types of investors); and ***swap agreements***.
(x)	Y	Y	**Municipal Securities.**
(xi)	500	(500*)	***De Minimis* brokerage.** GLB exempts up to 500 brokerage transactions annually for each bank, so long as the bank transactions are not conducted by bank employees who are also employees of a broker-dealer. ***USA exempts up to 500 trades, if the transactions are unsolicited. Thus, a community bank can still conduct unsolicited "accommodation" trades for their customers.**

HOUSE BILL 2347
PROPOSED 2003 SECURITIES PENALTIES AMENDMENTS
Kansas Securities Commissioner

Section 37(a)(2) - Securities Fraud: Replace K.S.A. 17-1253(f) to increase criminal penalties to severity levels 3 through 6 based upon the amount of loss rather than a single severity level 6 felony.

SECURITIES FRAUD	Current Severity Level with Sentencing Range for Defendant with No Prior Convictions		Proposed Severity Level with Sentencing Range for Defendant with No Prior Convictions	
$1,000,000 or more	Level 6	17-19 months	Level 3	55-61 months
$100,000 but less than $1,000,000	Level 6	17-19 months	Level 4	38-43 months
$25,000 but less than $100,000	Level 6	17-19 months	Level 5	31-34 months
Less than $25,000	Level 6	17-19 months	Level 6	17-19 months

Section 37(a)(3) - Unregistered Agents: Replace K.S.A. 17-1254(f) to increase criminal penalties for offering or selling securities without being registered as a broker-dealer, agent, investment adviser or investment adviser representative to severity levels 4 through 7 based upon the amount of loss rather than a single severity level 7 felony.

Section 37(a)(3) - Unregistered Securities: Replace K.S.A. 17-1255(b) to increase the criminal penalties for unlawfully offering or selling securities to severity levels 4 through 7 based upon amount of loss rather than a single severity level 7 felony.

Section 34(a) and 37(a)(4) - False Filings: Replace K.S.A. 17-1264 to increase the criminal penalty for the filing of a false and misleading statement from level 10 to level 8.

Section 41(a)(4) - Scope of Investigations: Replace K.S.A. 17-1265 to enable securities investigators to investigate other criminal acts if discovered during the course of securities investigation. This type of authority is already granted to law enforcement officers with other state agencies (Revenue, Lottery, and Racing and Gaming).

Sections 29(c)(3) and 43(b)(1) - Fines: Replace K.S.A. 17-1266a to increase the maximum fine from $5,000 to $10,000 in administrative proceedings.

Section 60 - Sentencing Guidelines Grid: Addition of subsection (m) to retain the current $25,000 threshold for presumptive imprisonment.

Section 34(b) - Financial Statements and Appraisals: Add new state law to prohibit influencing or misleading persons in the preparation of financial statements or appraisals.

Section 34(c) - Destruction of Documents and Retaliation against Informants: Add new state law to prohibit the destruction or falsifying of records and protect whistleblowers from retaliation for providing truthful information.

LAW OFFICES OF
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February 18, 2003

Mr. David Brant
Securities Commissioner
Office of the Kansas Securities Commissioner
618 S. Kansas Avenue
Topeka, Kansas 66603

Re: Kansas Security Laws/Senate Bill 110/House Bill 2347

Dear Mr. Brant:

This will acknowledge yours of February 13, 2003. Although I have not had the opportunity to review HB 2347, being a total rewrite of the Kansas securities laws, I'm sufficiently familiar with the existing statutes, as to be persuaded that a total rewrite is most appropriate. Far too many Kansans, particularly the elderly and those less versed in the nuances of investment, securities and the regulations thereof, are victimized by unscrupulous, unethical, and even criminal purveyors of alleged investments which are really nothing but quick rich schemes for the purveyor. It has been my observation over about the last 20 years that the penalties for the violating of such laws are insufficient.

In addressing the penalties, I would hope that there would be provision made for the pursuit of the fruits of illegal activity to be available, to include whatever real or personal property was obtained, in whole or in part, with the proceeds of illegal activity, so that their profits cannot be "squirreled away" and unavailable to be recouped for the benefit of their victims, and/or for the payment of fines and penalties. Law enforcement has found the "forfeiture" laws in regards to drug trafficking to be an extremely valuable tool. A similar concept would be most appropriate in white collar crime situations. One needs only to look at Enron, et al. to see the gross injustice, and the outrage of the victims, when the corporate criminal is living in $5, $10, $20 million dollar homes, driving 2, 3, 4 imported luxury vehicles, having ski lodges in Aspen, etc., while their victims have been made impecunious.

Of course, not only should their profits be taken from them, but prison time should be available and, in my judgment, the prison time should be available and the offenses should be classified in the Sentencing Guidelines as presumptive imprisonment.

I thank you for your efforts in attempting to improve the civil and criminal laws that provide for the regulation of the securities and investment industries, for neither they nor the Kansas economy can succeed unless people have the credible reliance upon the integrity of the system.

Very truly yours,

Robert D. Hecht
District Attorney

RDH/clk

March 15, 2002

NASAA Roundtable Forum

Functional Regulation in the 21st Century:

What's Reasonable for Investor Protection and for Agents Selling Variable Products?

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Concerns about Agents and Sales of Variable Products

I. Background

a. The primary focus of this report is on sales of variable annuities to seniors

i. No studies have apparently been done on the increase in fraud rates, but anecdotal evidence from financial advisors (accountants, planners, attorneys, and so on) has been mounting rapidly over the past five years with a significant increase in the last 18 months.

ii. Seniors are considered the primary target for insurance marketers since many have low interest bearing certificates of deposit and other low income producing investments.

iii. It's often relatively easy to cross sell to seniors. A typical sales seminar might cover annuities, long term care, estate planning with life insurance, and Medicaid planning.

b. Other areas of concern

i. Inappropriate sales of variable life insurance

1. As consumer gets older, the cost of life insurance becomes more expensive. In an effort to minimize premium cost, many agents sell variable life on a minimum pay basis with a high earnings rate assumption such as 12%. These contracts have been lapsing in recent months, when the buyers could not afford to increase premium outlay to cover investment losses.

2. Variable products are being sold as "retirement plans" with little or no disclosure that the consumer is actually purchasing life insurance.

ii. Equity index funds – While not considered a security at this time, these contracts are becoming extremely popular with sales people since they don't require securities licensing. Unfortunately for the consumer, the products are overly complex and yet there is little or no disclosure or suitability requirements at this time.

II. Why Seniors?

a. Many seniors are dissatisfied with the low interest rates on their Certificates of Deposit or Municipal Bonds.

b. They are often extremely tax sensitive, even though many aren't in a high tax bracket.

c. They have some spare time and like to attend educational seminars.

d. They are often keenly aware that they have retirement planning and estate planning needs.

III. Why Variable Annuities?

a. Commissions

   i. Extremely high compensation rates – Variable annuities pay roughly 6% - 8% compared to mutual funds which average 2% - 6%.

   ii. Commissions are heaped (they are paid in the first year, rather than spread out over several years).

   iii. Unlike mutual funds, there are no breakpoints – commissions aren't reduced when selling larger amounts.

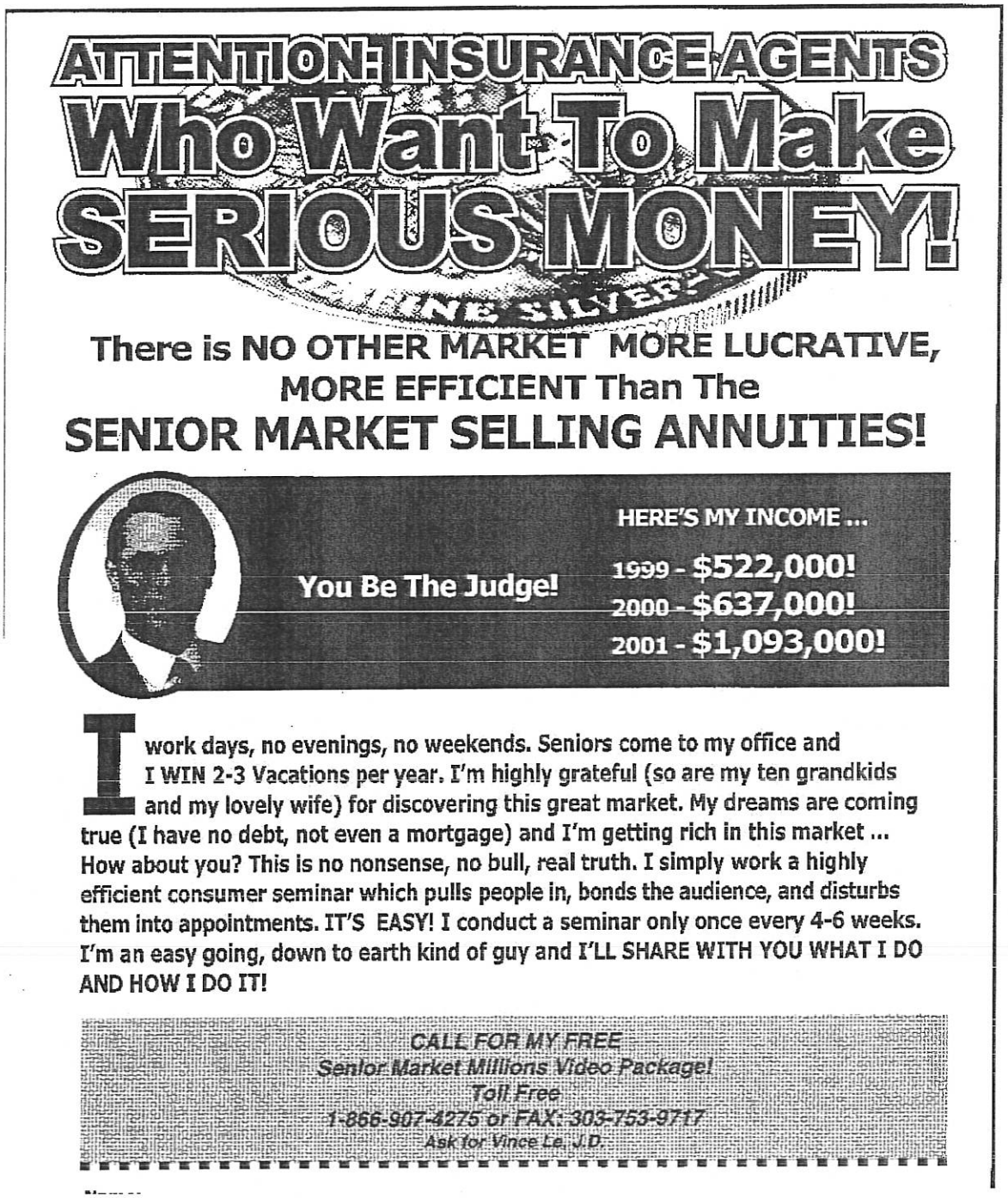
b. The product is deceptively simple to describe

   i. The benefits are often touted while disadvantages are ignored.

   ii. Many insurance agents don't fully understand the products or their complicated tax results.

   iii. The products are evolving very quickly, making it difficult for agents to keep current.

c. Agents are barraged with marketing from insurance companies and brokerage firms (See Advertisements below).



Source: *Life Insurance Selling* Magazine

Seniors First, Inc.

SENIOR ESTATE AND FINANCIAL PLANNING

TESTIMONIAL

Since I've started using seminars and Larry Kline's newsletter, as well as employing many of his other systems into my practice my production has sky rocketed! My results are as follows:

1996 $1,300,000 of fixed annuity production
1997 $3,100,000 of fixed annuity production
1998 $5,100,000 of fixed annuity production
1999 $7,200,000 of fixed/variable annuity and equities (produced in 7 months)

We are projecting 12 to 15 million of production this year, and by the way I don't work evenings or weekends. Thanks in large part to Larry Kline and his systems my employees, family, and my church have enjoyed success beyond my expectations.

I retired from meat cutting in 1995 on the advice of doctors after seventeen different surgeries on my hands and arms. My choice was to continue cutting meat and eventually lose functional use of my right hand or find another career that wouldn't ruin my right hand and wrist. I'm sure glad that I made the choice to change my job, little did I know then, that I would be where I am now.

IF A MEAT CUTTER WITHOUT A COLLEGE EDUCATION CAN ACHIEVE THESE KIND OF RESULTS THEN I BELIEVE ANY CAN! Imagine what a person with previous experience in financial planning could accomplish.

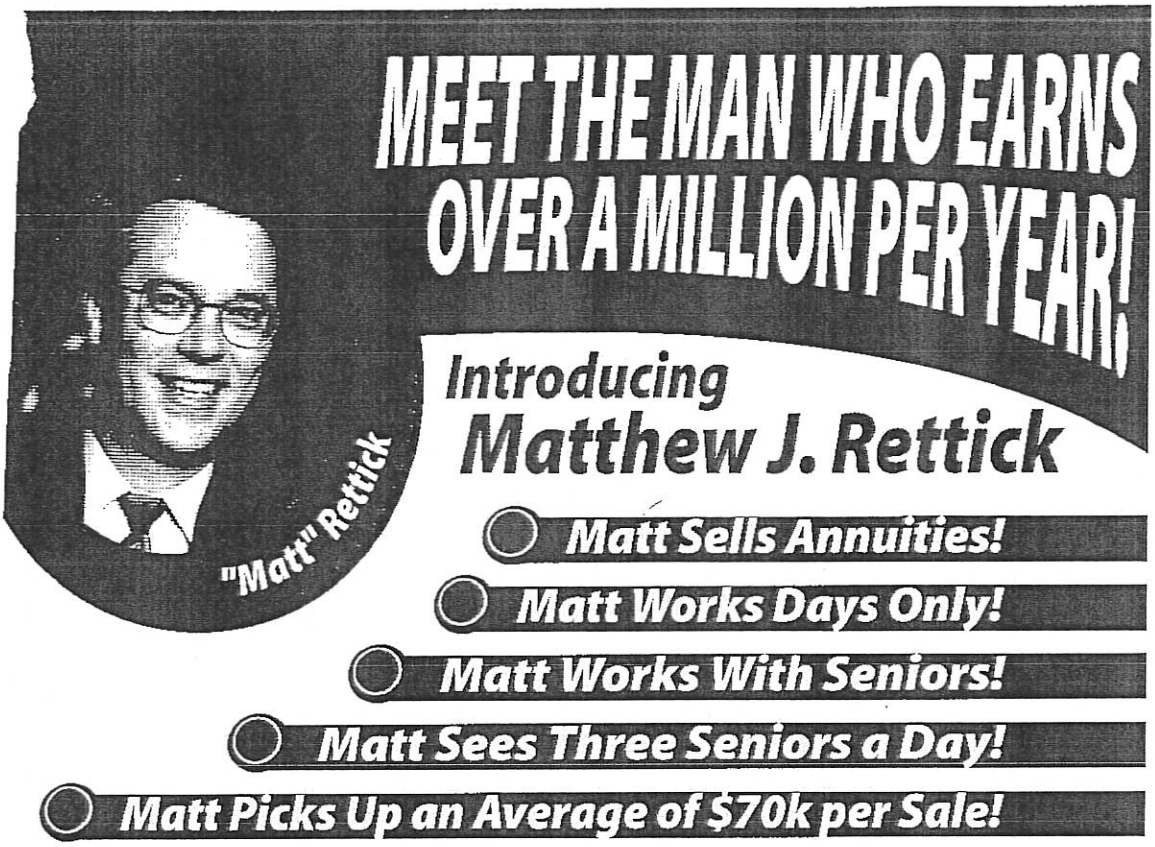
DON'T KILL TIME WORK IT TO DEATH

INVEST IN YOUR BUSINESS

GIVE IN ORDER TO RECIEVE

Steven R. Hansen CSA

Source: NF Communications, Inc.



Source: *Broker World* Magazine

FREE Book Reveals...

"How I Convert CD's To Annuities And Produce $67,480 In Earnings With 10 Appointments A Month"

Years ago, I realized that I worked too hard to make a decent living in the financial services industry. Prospecting the "old fashioned" way became more and more cumbersome. I started to look for a way to make prospects call me, rather than me chasing after them.

I created an "auto pilot" lead generation and closing system, tweaked it and tested it until it worked. Now I receive 32 calls every month from people who ask for help making more interest with less taxes. Usually I meet with 10 prospects and close 7 cases with an average annuity premium of $60,000.

Hello, name is Hans W. Jenau. I am the proud father of two beautiful young girls who need me to be there while they are growing up. My time of meeting people, who need to be convinced that bank CD's are not the best savings vehicle, is over.

To educate my prospects about the "hidden agendas" of CD's and powerful solutions, I wrote a book, that opens their eyes and reveals little known facts. Many prospects tell me they felt that something was not right with CD's, but never knew what it was, until they read my book.

A few months ago I introduced The Comprehensive Annuity Marketing Guide to some of my peers around the country. Their response was: "How can I license your program in my neck of the woods?"

Their Opinion Is Reflected In Their Comments Below:

"Dear Hans, I would like to congratulate you to the work that you have done in putting together "The Comprehensive Annuity Marketing Guide." It has proven to be a real positive addition to my marketing efforts.

Since I have started using your program, I have generated over 100 leads using your ideas. In the next week, I will close two annuity sales that will total $240,000 of premium. These sales will have happened before I have had a chance to work through 75 of the leads that are now on my desk.

I would highly recommend this program to any producer who wants to build their book of business."
- Keith Stechmesser, MBA, CFP, Englewood, CO

"Just a short note to report our success with the CD booklets. We ran our first ad 3 days ago and have 44 responses to date. To make that even better, we are located in a snowbird area and the snowbirds have already left. Normally marketing efforts at this time of year produces very low results. We know it from 13 years experience in this area. We are very pleased with your program. P.S. we have ordered 500 more booklets." - Charles D. Wood, Harlingen, TX

Have You Been Disappointed

with lead generation systems and direct mail success? It will be my pleasure to send you detailed information about my system and a free copy of my book. You'll see right away why my System is so different and more effective than everything else out there.

The agents who use my system have told me how valuable it is to have my guidance on every step of how to be successful using my system, including things like...

- Exactly how, when and where to place your ads in the paper.
- Why only the "real 800" toll free phone number works.
- How to use my unique one page sales tool effectively and thus increasing your first appointment closing ratio by up to 25%. Prospects are eager to buy half way through the presentation.

My system is based on years of field sales experience, testing, tweaking and retesting. While I had to invest thousands of dollars at the start, I recovered all of it in bucketfuls with sales, after my system was perfected.

I will share with you what works, and equally important, what DOES NOT work. But you must qualify.

Here Is The Catch:

Licensing rights to my program, are selling like hot cakes. We will not saturate areas. Some territories may be closing soon. Don't wait, if you are serious about making more money with less efforts in the Trillion Dollar CD market.

To receive a **free copy of my book and all the details**, call my **FREE** recorded message:

800-711-8269

24 hours/7 days, and **leave your name and address.**

*Call today, Millions of Dollars of CD money are **maturing**, today, tomorrow; every day. Somebody is going to get it.*

For information circle no. 59

"How I Sell $300,000 In Annuities Every Month Without Making A Phone Call"

There's a bunch of annuity lead systems out there that will waste your time. They generate a ton of leads from tire kickers—people who are not serious. You go to their homes and they're not even there. You make dozens of phone calls chasing these low quality leads. There's no way I could waste my time like that.

So I developed a system for my own use that has 8 people a month calling me. The system only attracts people who already own annuities. Like you, I do not make money educating prospects about annuities. I want prospects that can easily be exchanged—prospects that have large accumulated annuity balances. They come to my office and half of them close. My average ticket is $72,600.

If you would like to stop wasting time, see people who are ready to buy, have them come to your office, then call for the free report describing my system.

FREE REPORT

"How I Sell $300,000 In Annuities Every Month Without Making A Phone Call."

Leave Your Address 24 hours 800-246-1665

NF COMMUNICATIONS, INC.

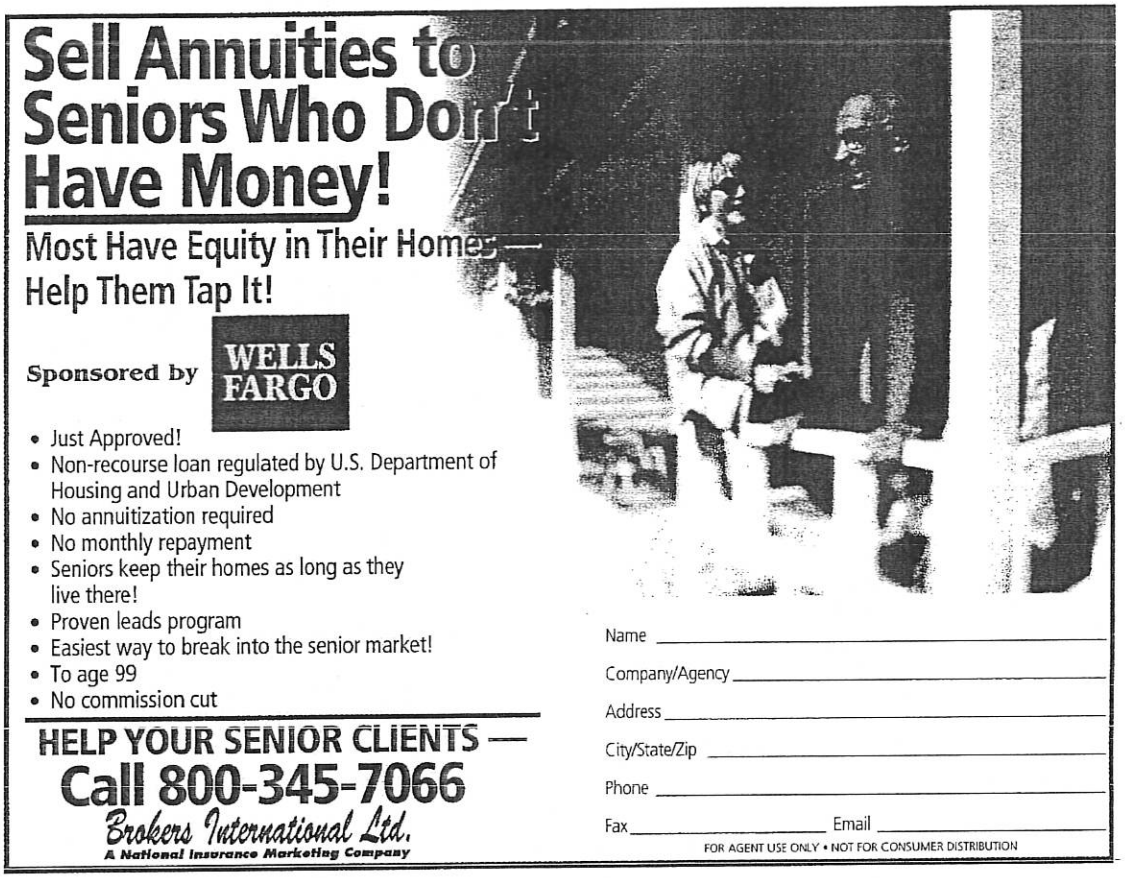
Selling To Seniors?

I WRITE 3-5 LTC APPS A DAY
AND HAVE SOLD
OVER 2500 LTC CASES!
I EARN $250,000 IN LTC RENEWALS
AND NOW SELL 500K OF ANNUITIES
PER MONTH
DURING THE SAME INTERVIEW, AND
ON ONE CALL!
YES, I 'M REAL! MY NAME IS
KARLAN T.
I'LL SHOW YOU HOW TO DO IT AT
MILLION DOLLAR ACADEMY™
IN LAS VEGAS ON OCTOBER 13 & 14
CALL ASAP TO REGISTER !

1-800 344-4105

"SPEND A NICKEL IN ORDER TO EARN A FORTUNE"

Source: *Life Insurance Selling* and *Broker World* Magazines



Source: Mass mailing sent to Maryland life agent licensees

IV. How Are Variable Annuities Being Marketed?

a. **Senior Seminars** – These are often held at senior centers and occasionally through church groups.

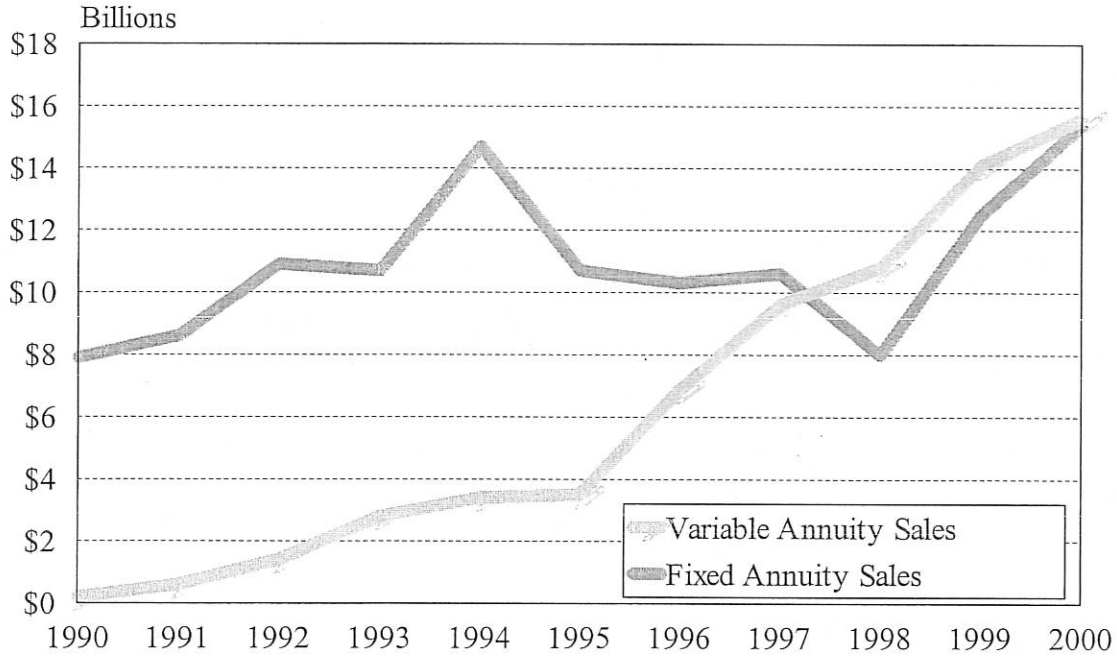
   i. Cross selling often involves Medicaid planning, long term care, and estate planning.

   ii. Living Trust mills – In this particularly abusive sales situation, an attorney or paralegal holds a seminar in which seniors are sold on the use of Living Trusts. The senior meets with the attorney after the seminar and the trust is drafted. A few days later, an annuity salesperson visits the senior and explains that in order to fund the new Living Trust, the senior must liquidate his or her assets and placed them all into an annuity.

b. **Banks** – Bank sales of variable annuities have blossomed in the past ten years. Salespeople employed by the bank work with existing clients to replace certificates of deposit with fixed and variable annuities

   i. From 1990 to 2000, bank variable annuity sales have jumped from $0.2 billion to $15.6 billion.

   ii. The difference in investment risk between certificates of deposit and variable annuities can be significant, and a number of seniors have been shocked to find that they have suffered significant losses in the past two years.



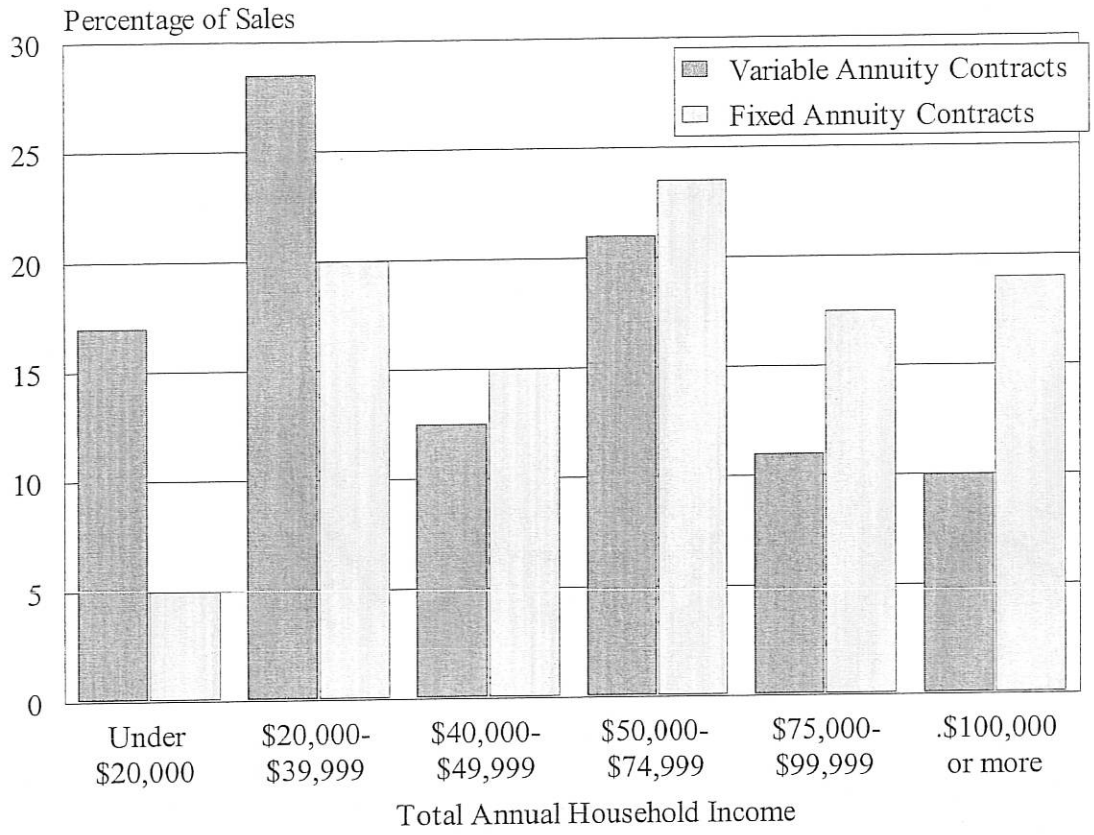
Annuities Sold Through Banks

Source: Kenneth Kehrer Associates, Princeton, NJ

c. **Targeted Marketing** – The typical variable annuity purchaser has a relatively moderate household income. The graph on the following page is a breakdown by household income of variable and fixed annuity sales in 1999.

   i. **Tax Deferral** - Surprisingly, approximately 58% of non qualified variable annuities were purchased by consumers with relatively low household incomes (less than $50,000). Almost 80% were purchased by households with less than $75,000 in annual income. Considering that tax-deferral is probably the most important feature for this product, it would appear that

those who are investing in variable contracts are already in the lower tax brackets.



Source: The Gallup Organization. Committee of Annuity Insurers
1999 Survey of Owners of Nonqualified Annuity Contracts

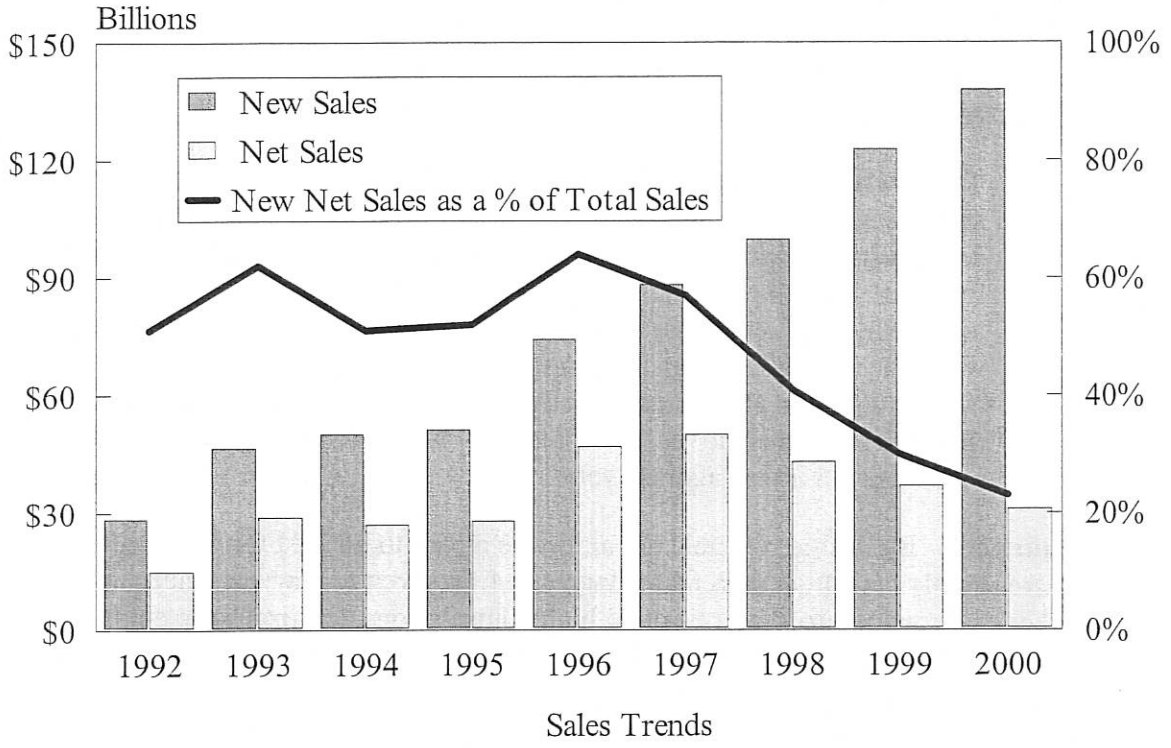
ii. **Investment Sophistication** – Most variable annuity contracts have been sold to lower income investors. It is likely that a significant number of these are less sophisticated investors in terms of experience and risk tolerance.

V. Sources of Money for News Sales

a. **CDs** – As seen in the advertising above, certificates of deposit are considered a prime candidate for annuity sales. Banks don't usually make much of an effort to conserve these investments, and in come cases, banks are the ones selling the new variable annuity.

b. **Existing annuities** – By far the most common variable annuity sale I've seen in the past five years has been the replacements of existing variable annuities with

new contracts. In fact, such replacements make up a substantial percentage of the sales numbers for the variable annuity industry. (See chart on the following page.)



Sales Trends

Sources: VARDS, Financial Research Corp., Cerulli Associates

i. **Industry Growth or Product Cannibalism?** – The typical historical sales chart for the variable annuity shows just the dark gray bars above. Sales have increased dramatically in the past ten years, with a recent decrease in 2001 of approximately 17.8%. Unfortunately, according to the chart above which was reproduced from AM Best's *Best Review* magazine, most of these new sales figures represent replacements of existing variable annuity contracts. In the year 2000, for example, the industry sold roughly $138 billion of variable annuity premiums. Of this amount, almost 80% represented replacement of existing contracts.

ii. **Qualified Retirement Plans** – A growing number of consumers have recently been investing their IRAs and qualified plan assets in variable annuities. Why this may be suitable for some situations, in general, such planning has been oversold.

VI. Sales Abuses

a. **Inappropriate Investment Risk** – A growing number of seniors have been moving savings from relatively safe CDs, government bonds, and other fixed income investments into variable annuities with little or no understanding of the underlying risk in the annuity subaccounts. It's not surprising that, as a result of the market instability of the past couple of years, variable annuities sales have decreased by roughly 17.8% in 2001 and that fixed annuity sales have increased.

   i. **Contractual Guarantees** – Many of the newer contracts offer a minimum death benefit guarantee or similar feature. I commonly run into senior variable annuity investors whose accounts are invested heavily in tech funds, small cap funds, and similar high risk subaccounts. When asked why they would assume such high level of risk in their annuities when their other holdings are primarily income oriented investments, these consumers often cite the death benefit guarantee feature. According to their sales representative, "there's no downside" to these policies so they might as well invest aggressively.

b. **Churning** – By design, variable annuities are meant to be held for the long term. There usually have high surrender charges in first seven to ten years, and with today's narrowing profit margins and high commissions, the insurance company doesn't break even on these contracts for several years. The inappropriate switching from variable annuity contract to variable annuity contract has increased dramatically in recent years.

c. **Bonus Rate Annuities** – Insurance companies have been gradually increasing the upfront bonuses on variable contracts, and these bonus rates have had a dramatic effect on sales practices. For example, if a consumer has a variable annuity purchased three years earlier, it might have a 5% surrender charge remaining. When an agent offers a new contract with an 8% upfront bonus, the consumer is often led to believe that there is no penalty for moving the funds into the new account. In fact, according to the sales agent, they are now 3% ahead. There is little or no disclosure about increased internal fees and newer, longer surrender charges.

d. **Variable Annuities in Qualified Plans** – The press has recently been paying quite a bit of attention to sales of variable annuities inside IRAs and pension plans. While the industry has been defending this practice by stating that such sales are made for non-tax driven reasons, with death benefit guarantees the most often cited example, this doesn't match what we've been seeing in the field. A typical sales pitch touts the tax benefits of an annuity, and then works with the consumer to move whatever funds are available into these products.

VII. The State of the Insurance Industry – At this time, the variable marketplace is dominated by twenty five insurance companies. In an attempt to increase market share, many of these carriers have been taking increasingly aggressive steps to lure in new clients. Some of this money comes from mutual funds, and CDS, and individual stocks and bonds, but most of it seems to be flowing from competitor's annuity contracts. Sales have fallen in each of the last five quarters, and as a result, sales pressures have increased dramatically. There are several inherent problems with this stepped up competition.

a. **Commissions have been steadily increasing**. Furthermore, these commissions are heaped (paid up front) so advisors have little incentive to service and retain existing contracts.

b. **Bonus rates have been increasing dramatically.** In the past few years, bonus rates have jumped from 2 - 3% to 8 and in some cases even 10%. This entices clients to leave existing contracts during the surrender charge period, and makes it easier for agents to churn accounts.

c. **Death benefit guarantees have become increasing aggressive**. As long as the stock market was thriving, such guarantees didn't have an adverse effect on an insurance company's financial stability. With the recent downturn in the stock market, some contracts are experiencing as much as a 70% loss, and when these annuitants pass away, the insurance company must cover this loss. Since increasing death benefit guarantees were often used to entice consumers to switch from an older contract to a new one, there are a substantial number of policies in force today which hold significant risk to the insurance companies. Reinsurance has been drying up for these contracts, and despite the warning signs, insurance companies have been increasing their marketing efforts rather than rethinking this strategy.

d. **Narrowing Profit Margins** – Profit pressures have been intensifying in the past couple of years. If, in order to maintain or increase market share, an insurance company increases commissions, bonuses, and guarantees, the breakeven point for selling such policies is pushed farther and farther into the future. Since profits generally come from a percentage-based set of fees, when a company's asset base decreases, profits are decreased.

e. **Hedging Risk is Difficult for the Company** - If a consumer manages his or her own subaccounts badly, the insurance company's profit decreases. If a consumer passes away in a down market year, the insurance company will have to sustain a significant loss on that consumer's contract.

VIII. **Conclusion**

a. For those of us who work with consumers, complaints about variable annuities have been getting more and more frequent, especially in the past 18 months. Generally these annuity owners are seniors, and usually, they have little or no understanding of the contracts they've purchased. Many are only currently reviewing their plans at this time because they've lost money in the market. They invested $100,000 in 2000 and now they only have $75,000. They approach their accountants, attorneys, and planners with the question, "How could this have happened?" It is only then that the advisors find evidence of churning and bonus rate sales and inadequate disclosures and about costs and risks.

b. Insurance agents have substantial pressure to sell new variable contracts and little financial incentive to service or conserve existing policies. Insurance companies are feeling increased competition and are assuming high levels of risk to establish market share. As a result, more and more seniors are being pushed into inappropriate products, and convinced to roll these funds from company to company. They do not understand what they are buying, and once they are invested in these products, it is exceedingly difficult to divest without significant penalties and high taxes.

7-20-02

Securities Comission:

I received this letter from
I didn't buy this investment for the death benefits. I bought it for use while alive, I want my money back so I can move it to an investment value I can withdraw without a penalty.

When I received the prospectus and contract, I never understood the part about surrender period, stock market and funds allocations and I never knew what questions to ask. He could have been more thorough in the explanations, instead he kept calling me to try to sell me more investments, but he never reviewed or explained the policy more thoroughly and I did not know what to ask.

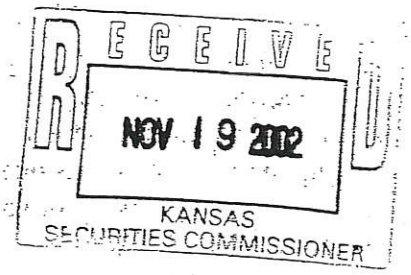
I had access to all of the fund, and now I have five more years of penalties with He should have recommended I stay" with and move to a safer bond or fund or If you can help me anyway, please let me know.

Sincerely

Wichita, KS

7-26

November 16, 2002



Kansas Securities Commissioners Office
Attn: David Brant
618 South Kansas Avenue, 2nd Floor
Topeka KS 66603

Commissioner Brant,

My wife and I wanted to write this letter and let you know how our variable annuity product has affected our lives.

We met with when I retired From Jeffrey Energy Center in January. I will be 60 years old soon and my wife is a few years younger than I am. I needed to rollover a 401K account and a co-worker gave us 's name. My wife and I met with two brief times at his office. During these two meetings we talked about what we needed and our in-experience with this entire process. Other than my 401K account, my wife and I had no other savings, this is all we had. We went over this with , we didn't want to loose any of our money and that we didn't care if the account grew at all, just that we did not want to lose any of our base money. We still owe money on our house, our vehicles, and have other basic debt. We depended on him help us with this! We were very clear in our meeting that we had no risk tolerance at all, and that we didn't want in the stock market. We mentioned that we had heard bonds were safe and we were interested in them. He gave us a prospectus to read after our meeting. I graduated from the eight grade but didn't go to high school and my wife finished high school. The prospectus that he gave us, for us, was like a foreign language. We couldn't understand anything the prospectus was telling us! We were embarrassed to ask a lot of questions. We left his office knowing that we were not in the stock market; we were in bonds.

We received our first statement about three months after we opened our account with . Much to our surprise we had lost 20 percent of our account! We only had $100,000 to begin with and we had just lost over $20,000.00, which is the world to us! I was angry and all my wife could do was cry! Mr. during these three months, never called us or made any contact with us to let us know what was going on with our account! We immediately called his office and set up a meeting with him. During this meeting all he kept telling my wife is that when I died she would get the base money back. We didn't even know that it like an insurance policy. My wife cried during the entire meeting and I didn't know what to do. We both have life insurance policies and we really didn't need any more. We wanted to preserve our base money! During the meeting, did switch our account over to be invested in bonds.

Losing this amount of money, to us, is like our live savings! When I retired I wanted us to be able to do the things that we wanted to. My wife continues to work and I work full time. Not what we had in mind. I wanted to take a trip this summer for our 35th wedding anniversary, and now I don't know if we can even do that!

We opened a case with the Kansas Securities Commissioners office in hopes that they could help us get our base amount back and our money away from Mr. . We also wanted to try and help other people like us! At least now, if someone calls for a background check on Mr. , they will see what he has done to us! We put our trust in We thought we were doing the right thing. He knew that we had no tolerance for risk, he knew that we had no idea what we were doing, he knew that we had no experience with the stock market, and he still invested us in stuff that we had no business investing in at our age! We come from a time that you could trust the person that your doing business with.

If there is anything else that we can do to help, please let us know.

Sincerely,

St. Marys KS

7.28

To Whom it may Concern:

In regards to our investments with Money when the agent was

We were never told that they were Connected to the stock market, which we knew nothing about, and many other things that we didn't understand — we told over and over that we didn't understand the dealings and we were trusting him to do the right thing, but he also knew that we were both diagnosed with cancer, one in 1994 and one in 1995 and yet he cashed in all of life insurance policies to put in his Annuities because they would make more money than the policies — You should be able to trust your agent.

Also the life insurance policy with that has a big debt against it — we have no idea why he did that — we ask questions about it, but never got an answer that we understood — we still don't know anything about it, except we're paying the interest every year.

This is an example of senior citizens being trusting of someone that was supposed to be a friend, and also how many people our age know anything about the stock market?

Signed Sept. 22, 2002

November 4, 2002

David Brant:
Securities Commissioner

Dear Mr. Brant:

I am 60 years old and disabled. My disability forced me to retire from Hallmark Cards in March 2000. At the time, my wife was undergoing treatment for cancer. The combined medical bills were staggering and we sold our home and furniture to pay them. This left us with social security disability and my Hallmark pension to meet living expenses. Our agent, went to Hallmark with me to insure that my pension distribution was transferred to his firm. He assured us that we would be much better off at than simply receiving a pension payment from Hallmark. I established an Individual Retirement Annuity with and Hallmark transferred $508,605. We needed conservative investments for an immediate monthly income but the entire amount was invested in stock variable annuities that paid little or no income. We were told that these funds would allow us to withdraw $4,250 per month and began withdrawing that amount.

But the stock funds that we were told had such good records began going down almost immediately. We expressed our concern in the first months and on several later occasions only to be told that we needed to stay the course. Because the agent ; we trusted him and went along. We do not think he intentionally tried to hurt us, but we are financially ruined nevertheless. We were withdrawing money from the principal for monthly income and the principal was losing value at the same time. We finally had to get out before it was all gone. When we transferred the money out in October 2001 there was only $277,298 left after paying penalties. We were penalized because they lost our money.

Unfortunately, things did not improve. We met a agent from church. We told him of our precarious situation and anguish at having lost so much of our life savings. He told us that what had happened to us was "criminal" and that if we transferred to him, he would take care of us. He placed us in different annuity stock funds managed by We stopped taking monthly income but the funds still lost money. Of the $277,298 transferred to in November 2001, only $214,169 remained eleven months later.

We hired a lawyer and has returned our principal but we had another year without any income. says that we should have been more careful and we could have transferred our money to safer investments at any time. But their agent told us not to transfer because that we had the best way to earn retirement income. No one ever told us that we were risking half my pension by placing it with an insurance company. The money we took was spent on groceries and rent and other living expenses and we can not replace it. We both have health problems and do not look forward to a legal battle with to get our money back. But we have no choice. I am an artist, not an accountant or investment expert. Is there no protection for people like us?

Yours truly,

Overland Park, KS

7-30

David Brant
Securities Commissioner
State of Kansas
618 S. Kansas Ave.
Topeka, KS 66603-3804

Re: Sales to me of variable annuity by

Dear Mr. Brant:

I worked in management the majority of my thirty-four years at Hallmark cards. In 1999, I was considering taking early retirement. Based on a friend's recommendation, I contacted in Overland Park. I showed them my $500,000 profit sharing account at Hallmark and asked whether they thought I had enough money to retire. I was fifty-four years old.

They reviewed my Hallmark plans, ran some projections using a "conservative" rate and told me they would guarantee me $2800 of monthly income using an annuity and mutual funds. This would be enough to maintain our standard of living. They told me that I could take the monthly sum until I reached the normal retirement age with no tax consequences and still have all of my principal. They sold me a annuity in the amount of $339,650.00 and invested another $90,000 in Van Kampen class B shares, which they said would be safe, and would guarantee us this income. My wife asked them what the commission or charge would be and they said that I would never see any commission. She asked them what it would be if we saw it, and they said it would be only one percent or so. We have since learned that was false.

Based on their advice, I retired from Hallmark Cards. My wife and I relied on their advice and projections in making this decision. Unfortunately, they invested my money in stock funds and I have lost almost $200,000 of my pension. I am only glad that I did not give them all of my retirement money but kept $80,000 at Hallmark, from which I have withdrawn funds as a cash reserve.

I became alarmed when the account dropped and met with them in December of 2000. I asked them what they thought we should do because the account has lost money. They assured me that they were watching the account and I should not worry. They told me to let them do the worrying and that they would make any changes they thought necessary. The account continued to go down during the year 2001, and again, I repeatedly asked them for help. They were very curt with me, and did not seem concerned that my life savings were being destroyed and that I had no other income.

Finally, I have sought legal assistance and new financial advice. I have now learned that the variable annuity had no guarantees, and provided a large commission to the brokers. I did not know it had a death benefit and did not want life insurance. American Insurance is trying to say that I knew this was insurance, but that is untrue.

I have been looking for a job, but it is not easy at my age to find anything. Due to the fraudulent sales to me of this variable annuity, my wife and I have had many sleepless nights. We have had to be very cautious of what we spend and are worried about our future. has refused to give us our money back and we have had

to hire an attorney. We have also lost approximately 74% of the $96,000 they invested in mutual funds.

I did not understand that my monthly payments were not guaranteed. I did not know that I could lose principal and might not be able to continue to withdraw the money. I did not know that if I stopped or changed the distributions, I would fact a tax liability. With over $500,000 in my retirement plan, I should have been able to retire easily if had not taken such risks with my savings in order to receive high commissions. I am writing this letter of complaint to ask you to help us get our money back and to investigate , and

Sincerely,

William

Brant, David

From: Tim and Kay Plumlee [plumlee@pld.com]
Sent: Sunday, February 16, 2003 7:39 PM
To: Brant, David
Subject: house bill 2347

FEBRUARY 15, 2003

CHAIRMAN O'NEAL

HOUSE JUDICIARY COMMITTEE
STATE CAPITOL - ROOM 313-S
TOPEKA, KS 66603

IN RE: HOUSE BILL 2347 - KANSAS UNIFORM SECURITIES ACT

CHAIRMAN O'NEAL AND THE JUDICIARY COMMITTEE:

I HAVE FILED A COMPLAINT WITH THE OFFICE OF THE KANSAS SECURITIES COMMISSIONER, THE KANSAS INSURANCE COMMISSIONER, AND THE NATIONAL ASSOCIATION OF SECURITIES DEALERS BECAUSE MY WIFE AND I WERE MISREPRESENTED IN OUR INVESTMENT OF MY 401K ROLLOVER IN SEPTEMBER, 2000.

I WORKED FORTY YEARS FOR A CARBON BLACK COMPANY AND INVESTED IN MY 401K. MY WIFE AND I SUPPORTED OUR THREE CHILDREN THROUGH A TOTAL OF NINETEEN YEARS OF COLLEGE SO THEY MIGHT BE ABLE TO MAKE A RESPECTIBLE LIVING DURING THEIR LIFETIMES. WE HAVE LIVED OUR LIVES VERY CONSERVATIVELY IN ORDER TO AFFORD THIS NINETEEN YEARS OF COLLEGE AND ALSO BE ABLE TO SUPPORT OURSELVES DURING OUR RETIREMENT.

SHORTLY BEFORE MY RETIREMENT IN 2000, I WAS APPROACHED BY A FRIEND THAT I HAD KNOWN FOR EIGHTEEN YEARS. HE WENT OUT OF HIS WAY TO PROPOSITION ME WITH AN INVESTMENT OPPORTUNITY THAT WOULD AFFORD ME AND MY WIFE THE GUARANTEE OF A SIX PERCENT INTEREST ON THE INVESTMENT OF MY 401K. THE PROPOSITION WAS SIMPLE--OUR INVESTMENT WOULD BE GUARANTEED FOR SIX PERCENT INTEREST. ALL WE HAD TO DO WAS TO LEAVE IT INVESTED FOR SEVEN YEARS. WE ASKED QUESTIONS BUT HE EXPLAINED IN TERMS THAT WERE NOT UNDERSTANDABLE TO US. MY WIFE INDICATED WE WANTED TO INVEST CONSERVATIVELY IN INTEREST BEARING ACCOUNTS, BUT HE INSISTED IT WAS ALREADY DETERMINED AS TO WHAT OUR INVESTMENT WOULD BE.

LARRY FILLED OUT ALL OF MY APPLICATIONS EXCEPT WHERE I SIGNED MY NAME. HE QUICKLY REMOVED EACH ONE AFTER I SIGNED THEM AND WENT ON TO ANOTHER. SEVERAL DAYS LATER LARRY BROUGHT THE PORTFOLIO BY OUR HOUSE. WE DID NOT UNDERSTAND IT ENOUGH TO KNOW WHAT IT MEANT. WE HAD MISTAKENLY PLACED OUR TRUST IN LARRY.

MY WIFE AND I HAVE NOT HAD ANY PERSONAL DEALINGS WITH STOCK INVESTMENTS. LARRY KNEW WHAT MINIMUM KNOWLEDGE WE HAD OF THE STOCK MARKET-- HE ALSO KNEW THAT OUR RETIREMENT INCOME IS A MINIMUM OF WHAT WE NEED TO EXIST. LARRY ALSO KNEW THAT WE STILL HAVE TEN YEARS TO PAY OFF THE LOAN ON OUR HOUSE. WE PAID OFF THE LAST COLLEGE LOAN FOR OUR CHILDREN A YEAR AGO.

MY WIFE HAD A SERIOUS BACK SURGERY A YEAR BEFORE I RETIRED. I RECENTLY HAD SURGERY FOR CANCER OF THE PROSTATE, AND MY WIFE IS TO HAVE ANOTHER SERIOUS SURGERY ON HER SPINE IN THE NEAR FUTURE. SHE SUFFERS FROM HIGH BLOOD PRESSURE AND DIABETES.

WE HAVE ASKED LARRY TO EXPLAIN TO US ON SEVERAL OCCASSIONS AS TO WHAT EXACTLY WE INVESTED IN AND HOW IT ACTUALLY WORKS IN LAYMAN TERMS SO THAT WE COULD UNDERSTAND. HIS REPLY WAS THAT BECAUSE OF HIS FORESIGHT WE WOULD RECEIVE OUR INITAL INVESTMENT PLUS SIX PERCENT IN ONE LUMP SUM AFTER SEVEN YEARS. AFTER DEMANDING AN EXPLANATION ON PAPER, HE SHOCKED US BY FINALLY

TELLING US THAT WHAT WE HAD PURCHASED WAS ACTUALLY AN ANNUITY. THIS WAS THE VERY FIRST TIME HE HAD REVEALED THIS TO US. ALSO, WE WOULD NOT GET A LUMP SUM AS HE HAD PROMISED US, BUT INSTEAD WE WOULD RECEIVE AN AMOUNT EACH MONTH GUARANTEED FOR TEN YEARS. (THAT IS IF THE COMPANY THAT GUARANTEED OUR INVESTMENT IS STILL IN BUSINESS). OUR STOCK INVESTMENT (AS WE J RECENTLY WERE INFORMED) IS IN HIGH RISK. PRESENTLY, OUR INVESTMENT OF $130,000 IS WORTH $60,000. WE WOULD HAVE NEVER INVESTED IN HIGH RISK OR IN AN ANNUITY IF WE HAD BEEN INFORMED OF WHAT LARRYWAS DOING WITH OUR 401K.

MY WIFE HAS SUFFERED IRREPAIRABLE HARM TO HER NERVOUS SYSTEM FROM HER CONSTANT WORRYING ABOUT WHAT LARRY HAS DONE TO OUR FINANCIAL FUTURE. SHE HAS TROUBLE SLEEPING, INTERMITTENLY HAS A RACING HEART, AND WE BOTH AGONIZE ABOUT HOW UNFAIR IT IS THAT LARRY WAS ABLE TO CHEAT US OUT OF OUR LIFE SAVINGS. OUR INVESTMENT IS ALL THAT WE HAVE IN THE WORLD.

LARRY BASICALLY STOLE OUR LIFETIME SAVINGS, MISREPRESENTED US AS TO WHERE HE WAS PLACING OUR INVESTMENT, AND HAS COST MY WIFE A MAJOR PART OF HER HEALTH. THIS WAS ALL DONE FOR HIS OWN MONETARY GAIN WITH NO REGARD AS TO THE DAMAGE HE HAS INFLECTED ON OUR LIVES.

HIS INVESTMENTS WERE NOT SUITABLE FOR OUR AGES OR STATION IN LIFE, OR OUR FINANCIAL REQUIREMENTS. ALSO, HE TOOK ADVANTAGE OF OUR TRUST IN HIM AND OUR LACK OF KNOWLEDGE AND EXPERIENCE IN THE STOCK MARKET.

THE ELDERLY DESERVE PROTECTION FROM SUCH PREDATORS AS OUR FINANCIAL ADVISOR. THE INVESTMENT COUNSELORS ARE BEING ALLOWED TO STEAL THE ELDERLY'S FUTURE AND CONSEQUENTLY INFLECTING PERMANENT DAMAGE ON THEM FOR THE REMAINDER OF THEIR LIVES. WHAT IS THE DIFFERENCE BETWEEN WHAT LARRY HAS DONE TO OUR LIVES AND THE CRIMES CONVICTS IN PRISON HAVE COMMITTED???

I PRAY THAT YOU WILL CONSIDER HOUSE BILL 2347 TO PASS A STATE LAW TO CONFORM TO FEDERAL LAW IN THE TREATMENT OF VARIABLE ANNUITIES AS SECURITIES. IF YOU DO NOT PROTECT THE ELDERLY FROM HAVING THE REMAINDER OF THEIR LIVES RUINED FINANCIALLY--WHO WILL??? THANK YOU FOR YOUR TIME.

SINCERELY,

TIM PLUMLEE
1019 N. BAUGHMAN
ULYSSES, KS 67880
620-356-3599

July 26, 2002

Allstate Life Insurance
Tom Wilson, President
3100 Sanders Rd.
Suite J5D
Northbrook, IL 60062

Dear Mr. Wilson,

A little over a year ago, my husband passed away from a malignant brain tumor. It was a very emotional and stressful time for me and continues to be even now. He was ill for 16 months prior to his death.

He had a retirement fund through the university where he had worked for over 30 years. Someone put me in touch with a private investor, Brent McCune of Compass Financial Resources, who represents Allstate Life Insurance. My policy number is PA00059957.

As I stated already, I was very emotional at the time and couldn't seem to make any decisions for myself. So I relied on Mr. McCune to rollover this IRA and invest it wisely for me. As of the first of July of this year, I had already lost over $65,000. Because of my age and retirement approaching, it should have been invested in very secure bonds instead of the stock market. After much thought, I decided to transfer this to Vanguard and put it all in secure government bonds. I also became aware of the fact that I was paying 1.5 % for the handling of my account. Vanguard charges .25%.

Mr. McCune brought a document by this week (see enclosed copy) for me to sign stating that I was transferring this IRA account. He told me that I would have to pay 7% for taking my money out which amounts to approximately $15,000.

I know that I signed many documents a year ago, but this penalty amount seems very unfair. I was very vulnerable and in such an emotional turmoil, that I was not fully aware of what I was signing.

I would appreciate it so much if you would waive this penalty. I feel the loss of my husband and now this financial loss is more than I can bear.

Thanks for your consideration in this matter.

Sincerely,

Janice Stephens
18286 West 155th Terr.
Olathe, KS 66062

Enclosure

Cc: Brent McCune

Date: February 15, 2003

To: Rep. Mike O'Neal, Kansas House Judiciary Committee Chairman

From: Pamela Yost

RE: SUPPORT FOR HB2347 ON RECLASSIFICATION OF ANNUITIES

Dear Chairman O'Neal,

I am writing to express my support for HB2347 that is soon to be discussed in your committee. Based on a recent bad experience I had with an annuity product and with some unscrupulous actions on the part of the registered representative who counseled me through the transaction, I feel that Kansas needs to take a "get tough approach". I would like to see your committee start the wheels in motion to improve laws pertaining to annuities – including marketing, control, handling of annuity products and enforcement of violations by registered representatives and companies – in an effort to protect customers like myself from costly problems. The U.S. Securities and Exchange Commission (SEC), the National Association of Securities Dealers (NASD), numerous other states, and a number of national investment firms view annuities as securities (not as insurance products) for a number of solid reasons. I believe that now is the time for Kansas to revamp the way it views annuities and to adopt a set of standards, as have the SEC and many other states.

I would like to share with you my particular situation and also highlight some facts I discovered while doing my own research to help me learn what wrongdoings had been done to me. I then used these facts and data in my subsequent formal complaint to the Kansas Securities Commissioner (and ultimately to the SEC), on December 2, 2002.

MY SITUATION, REASONS BEHIIND MY FORMAL COMPLAINT

I discovered this past October 2002 that I had a problem, regarding a rollover I transacted just months earlier in the spring of 2002, when I was reviewing my Travelers L&A annuity account. Both my husband and I were consolidating our investments (i.e., his 401K and other accounts along with my Traveler's annuity

Pamela J. Yost
11837 Alderny Ct. ~ Wichita, Kansas 67212
(h) 316-721-9139 (w) 620-665-2226

and other investments) opening new accounts with another brokerage firm. During this review I discovered what appeared to be some stark differences between my Travelers annuity and my two previous accounts that rolled into this annuity (one a 403b annuity, the other an employer-provided pension plan). **Where my previous accounts did not have a Contingent Deferred Surrender Charge (CDSC), the new Traveler's annuity did have these fees. Plus, the Travelers annuity had other high administrative fees that my two previous accounts did not have.** I began asking questions, probing deeper into this and educating myself on how/why this could happen and also what/what not the registered representative was legally bound to provide to me (e.g., marketing, product recommendations, and transaction service). Needless to say, I was angered after what I found out:

1) Registered representatives are required to make only recommendations and do what is in the best interest of the customer;

2) SEC and NASD rules mandate that a representative not recommend to a client to roll/switch from one product with no costs to another product with costs;

3) Registered representative is required to provide full disclosure of all necessary facts and costs, thoroughly and completely so the customer knows and understands all of the specifics before making a decision;

4) Upon contract delivery to the customer, a signed delivery receipt shall be obtained, followed by a "10-day free-look" period and right of rescission, and this due process must be made clearly understood to the customer;

Subsequently, I then attempted on several occasions to coordinate with Travelers/Citistreet to address my concerns and try to get some answers and hopefully some resolution. I also was upset and angered to have experienced:

5) Virtually complete ignorance and several weeks of non-response from both the corporate office for Travelers/Citistreet and the regional office in Kansas in response to both letters and phone calls from me;

6) After several attempts, once I finally got in contact with someone I was told that nothing had been done wrong to me and that I didn't have a legitimate complaint.

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I had been unfairly treated, unscrupulously duped, and placed in a position to pay thousands $$$ in fee costs (CDSC). This registered representative acted in his own best interests (commissions) and not mine (avoiding high costs) by recommending me to roll/switch into an annuity account with CDSC costs that my two previous accounts did not have! He failed to fully disclose the important facts and costs with this new account and how they were different from my two previous accounts. Had I known this information, I obviously would have declined putting myself in this situation and would have left my two accounts intact. This representative never presented the contract to me, NEVER provided a full and complete explanation of my due process rights of acceptance, and NEVER afforded me with my "10-day free look" period of review, never provided me with a delivery receipt for my signature, and never afforded me the right to exercise my "right of rescission". The company and its regional office both acted abhorrently and with total disregard for me by first ignoring my numerous attempts to contact them and then by their explanation that nothing had been done wrong to me.

WHERE THINGS ARE AT TODAY WITH MY COMPLAINT

Obviously the Office of the Kansas Securities Commissioner found sufficient grounds with my complaint to accept it and conduct an investigation. That investigation is currently in process and no results have been brought to my attention to this date. I am expecting results however in the near future.

CONCLUSION

Had Kansas law been such as is proposed by the HB2347, then I and hundreds of other Kansans would not be the victims of unscrupulous treatment by representatives who ignore the requirements of their license, ignore their professional and ethical commitments, who apparently lack qualifications to deal in annuities, and have little fear of violating existing state law that is apparently weak in areas and lacks sufficiently strong enforcement measures.

Registered representatives are to make recommendations to customers that are in the best interests of the customer (and not their own – via commissions, higher costs, etc.). SEC regulations (and NASD policies) require that representatives serve the best interests of the customer/investor . . . that it is illegal to recommend

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to customers to 'switch' (roll-over) from one product to another that is more costly to the customer.

It is my understanding that Kansas is one of only a few states that still regards annuities has insurance products. The SEC, numerous states, and nearly all investment brokerage firms in fact regard annuities as securities because of their complexities and their many similarities to securities investments. **Management and enforcement falls under the jurisdiction of the securities officials. Regulatory and enforcement policies are written/enforced by securities officials.**

Marketing annuity products and explaining all the important details to customers is a function that seems to require more expertise than that required of and possessed by an insurance agent – expertise that a well-trained securities professional is required to possess. An irony to my dilemma is my husband recently joined a national brokerage firm and is in the process of studying the very things of which I have included as basis for my formal complaint. One note though: I stumbled across my dilemma before he even expressed an interest in the securities business and before he ever entertained the thought of becoming a securities representative – he has been a valuable source of information to me as well has other sources I have used up to this point.

In closing, I'm hopeful that my testimonial letter will help you out – for what was not supposed to happen to me, did happen. I believe this is one issue that could benefit by the reclassification of annuities as securities and then governed as such (instead of as an insurance product) with oversight from the Kansas Securities Commissioner. I want to express my support for HB2347 and hope that it will be enacted into Kansas law this coming session. I believe it's time that our State steps forward and addresses the problems experienced with annuities. Please feel free to contact me with any additional questions you may have. I will be happy to try to help as best as I can. Thank you for accepting my letter.

Sincerely,

_____

Pamela J. Yost

Pamela J. Yost
11837 Alderny Ct. ~ Wichita, Kansas 67212
(h) 316-721-9139 (w) 620-665-2226

AGENT LICENSING

Joe Smith*

EXAMPLE OF AN AGENT WHO LOST HIS STATE SECURITIES LICENSE... BUT HE CAN STILL SELL VARIABLE PRODUCTS... WHILE ADMINISTRATIVE AND LICENSING SANCTIONS ARE PENDING...

Jan. 2001: Agent was fired by a New York insurance company and its brokerage subsidiary for **"selling away"** of unregistered securities.

Agent allegedly sold more than $1 million in unregistered securities through at least 29 or more transactions to at least 11 or more of his insurance clients and to other investors to invest in Intermountain promissory notes, American Technology ATM scrip leases, and Trade Partners and Mutual Benefits viatical investments.

Mar. 2001: Agent was hired by a Kansas broker-dealer but his state securities license **transfer was not allowed** by the Kansas Securities Commissioner since Agent was under investigation.

Agent still has his life and variable insurance licenses and is still registered with the NASD.

Agent has worked with a number of his former insurance clients to switch to variable annuity products with a different insurer.

Jan. 2002: Kansas Securities Commissioner issues Notice of Intent to Impose Administrative Sanctions for alleged "selling away" violations.

Feb. 2002: A former insurance customer files a complaint against the insurance company claiming damages of approximately $300,000 for their investments in the unregistered securities. Other customers have also reportedly filed claims.

Jan. 2003: Administrative sanctions are pending and the issuance of a final order is imminent awaiting the signing of a Stipulation by the Agent.

* Not the actual name of the agent.

A Collection of Reported NASD Disciplinary Actions Involving Broker/Dealers Affiliated With Life Insurance Companies, or the Distribution of Annuities & Insurance Between August 2001 and August 2000

Prepared By

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

September 30, 2001

NASD Disciplinary Actions Reported for August 2001

- [redacted] Registered Representative, Overland Park, Kansas) submitted a Letter of Acceptance, Waiver, and Consent in which he was barred from association with any NASD member in any capacity. Without admitting or denying the allegations, [redacted] consented to the described sanctions and to the entry of findings that he received checks totaling $95,000 intended for the purchase of a fixed annuity and a variable universal life insurance policy. The NASD found that [redacted] endorsed the checks, purchased a fixed annuity for $75,000 and a variable universal life insurance policy for $10,000, and did not invest the remaining $10,000 as intended by the customer nor promptly return the remaining funds to the customer. The NASD also found that [redacted] failed to promptly invest the $75,000 in the fixed annuity as intended by the customer, and instead, held the funds in his account. (NASD Case #C04010023).

ACTIONS BY THE KANSAS SECURITIES COMMISSIONER

April 6, 2001	Notice of Intent issued with copies sent to NASD and to Kansas Insurance Commissioner.
June 13, 2001	Order of Sanctions that for two years [redacted] is BARRED from association with any broker-dealer or investment adviser Registered in Kansas.

VARIABLE ANNUITIES and FUNCTIONAL REGULATION

REGULATORS

Insurance	Securities		
KID	SEC	NASD	KSC
State	Federal	Industry	State

PRODUCT

INSURANCE COMPANY	KID	
Variable Annuity Contract	KID	
Separate Account and Prospectus	SEC	Preempted
Investment Company (mutual fund) Subaccounts	SEC	Preempted

SALE

BROKER-DEALER	SEC — NASD	KSC*
Sales Materials and Advertising	KID; SEC — NASD	
Sales Agent	KID; SEC — NASD	KSC* [1]
Suitability Review	SEC — NASD	KSC*
INVESTOR		

NOTES

* Proposed

[1] In Kansas, 93% of the agents selling variable annuities (as of 12/10/01) already also have a state securities license in order to sell other securities products such as mutual funds.

Draft 2/6/03

12/23/02

Comparison of State Functional Regulation
Insurance Companies and Broker Dealer Subsidiaries

	Insurance Aetna Life Insurance and Annuity Company Security Benefit Life Insurance Company		**Securities** Aetna Investment Services Securities Distributors, Inc.	
	***Before** USA (2002)*	***After** USA (2002)*	***Before** USA (2002)*	***After** USA (2002)*
State Registration	Insurance Company	Insurance Company	Broker-Dealer	Broker-Dealer
State Regulator	Insurance Commissioner	Insurance Commissioner	Securities Commissioner	Securities Commissioner
Type of Filing	NAIC	NAIC	CRD (electronic)	CRD (electronic)
Annual Fee	$110	$110	$200	$200
Products subject to regulation	All insurance and variable products	All insurance and variable products	Preempted from product regulation of "covered securities" including mutual funds and variable products	
Agent licensing and sales practices	Sales of insurance	Sales of insurance	Sales of securities <u>except</u> variable products	Sales of securities <u>including</u> variable products

12/23/02

Comparison of State Functional Regulation
Products and Agents

Product	Purpose	Considered a Security			Offered through Broker-Dealer	Registration/Qualification		
		Federal	Other States	Kansas		SEC	KS Securities	KS Insurance
Mutual Funds	**Investment**	Yes	All	Yes	Yes	Yes	Notice Filing (covered security)	NA
Variable Annuities (with mutual fund options)	**Investment** and Insurance	Yes	17[1]	*No*	Yes	Yes	Exempt (covered security)	Yes

Agent	Affiliated with a Broker-Dealer	Licenses Required				Exams Required by Kansas	
		National Assoc. Securities Dealers	Other State Securities	KS Securities	KS Insurance	NASD	Blue Sky and Ethics
Mutual Funds	Yes	Yes	All	Yes	NA	Series 6	Series 63
Variable Annuities (with mutual fund options)	Yes	Yes	14[2]	*No*	Yes	Series 6	*None*

[1] Arizona, District of Columbia, Florida, Hawaii, Illinois Kentucky, Montana, Nevada, New Mexico, New York, North Dakota, Ohio, Rhode Island, South Dakota, Vermont, Washington and Puerto Rico.

[2] Alabama, Arizona, District of Columbia, Florida, Minnesota, Montana, Nevada, North Dakota, Rhode Island, South Dakota, Vermont, Washington, Wyoming and Puerto Rico.

Precedent of

FUNCTIONAL REGULATION

Insurance and Securities Commissioners
share jurisdiction over

VIATICAL SETTLEMENTS INDUSTRY

2002 House Bill 2640
supported by KAIFA

- insurance contract regulated by Insurance
- sales of investment products regulated by Securities
- agents selling viatical investments need Securities license
- Insurance and Securities Commissioners cooperate and share jurisdiction

7-45

K A N S A S

DAVID BRANT, COMMISSIONER

KATHLEEN SEBELIUS, GOVERNOR

OFFICE OF THE SECURITIES COMMISSIONER

February 18, 2003

Commissioner Sandy Praeger
Kansas Insurance Department
420 SW 9th Street
Topeka, Kansas 66612

Re: House Bill 2347 and Functional Regulation

Dear Commissioner Praeger:

We have recently discussed House Bill 2347 which would adopt the Kansas Uniform Securities Act. The bill would propose, among other things, that state law conform to federal law in the treatment of variable annuities as securities. This important change is achieved in the definition of "security" [Section 2, definition (28)] which does "not exclude" variable annuities. The provision will not affect insurance companies or the regulation of the products, but will enable state functional regulation of the agents who sell variable annuities.

Attached for your consideration is an "initial draft" of a cooperation agreement for our two agencies. We will need to further consult and meet with our respective staff members and attorneys to finalize some form of this agreement... should House Bill 2347 become law. The purpose of this agreement is to alleviate the insurance industry's concerns about duplicate and competing regulation of the sales of variable annuities. I would particularly highlight the provisions in Section 4 on page 3 which specifically address "variable products".

A similar agreement has been utilized in the State of Washington between the Insurance Commissioner and the Securities Director. The State of Washington adopted the proposed Uniform Securities Act definition of "security" in 2002.

Thank you for your consideration.

David Brant

DAVID BRANT
Commissioner

pc: Rep. Mike O'Neal and House Judiciary Committee

attachment

618 S. KANSAS AVENUE, TOPEKA, KS 66603
Voice 785-296-3307 Fax 785-296-6872 Investor Services 1-800-232-9580
http://www.securities.state.ks.us

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FUNCTIONAL REGULATION AND COOPERATION AGREEMENT BETWEEN THE KANSAS INSURANCE DEPARTMENT AND THE KANSAS SECURITIES COMMISSIONER

The Kansas Insurance Department (KID) regulates the business of insurance in the State of Kansas and serves as the primary regulator for all insurance entities domiciled in the state. The Kansas Securities Commissioner (KSC) is the state regulator of securities issuers, securities broker-dealers and their agents, and investment advisers and their representatives.

The KID and the KSC each possess financial, consumer complaint, enforcement and other information that may help the other party to more effectively carry out its regulatory responsibilities. To encourage the exchange of such information, the KID and the KSC agree to communicate and cooperate in the manner described below, subject to the conditions, obligations, and responsibilities set forth in this Agreement.

To avoid duplication, conflict, or contradiction in any regulatory examinations, investigations, or enforcement actions involving Regulated Persons which are subject to regulation by both Agencies, the KID and KSC agree to cooperate and work together, as appropriate, and otherwise to regulate only those functions of a Regulated Person within each Agency's statutory jurisdiction and as set forth in this Agreement.

1. Definitions

Affiliate means any person that controls, is controlled by, or is under common control of a Regulated Person, and any person that it is proposed will acquire or be subject to such control.

Agency or Agencies means the KID and the KSC, individually or together.

Confidential Information means any information which is identified as confidential by the Responding Agency to the Requesting Agency.

Enforcement action means a formal enforcement action taken through an administrative hearing, a civil or criminal court proceeding, a consent order, stipulated order and/or judgment.

Person means any individual, company, association, organization, group, partnership, business, trust, or corporation.

Information means Confidential Information and non-Confidential Information.

Regulated Person or Persons means a KID Regulated Person or a KSC Regulated Person.

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KID Regulated Person or Persons means an insurer, and any other person that KID has the authority to examine or regulate, and any Affiliate of such a person.

KSC Regulated Person or Persons means a securities issuer, securities broker-dealer and its agents, an investment adviser and its representatives, and any other person that KSC has the authority to examine or regulate, and any Affiliate of such a person.

Requesting Agency means the Agency seeking Information.

Responding Agency means the Agency responding to a request for Information.

Variable Products means variable annuity products and variable life insurance products.

2. Information Sharing

a) To the extent required or permitted by applicable law or practice, and to the extent that the requested Information concerning a Regulated Person is relevant or material to the Requesting Agency's lawful jurisdiction over the Regulated Person, either Agency may request Information from the other Agency regarding the financial solvency, insurance activities and/or securities activities of a Regulated Person.

b) Requests for Information shall be in writing. In submitting a request, the Requesting Agency shall provide a specific description, indicating the time period and general subject matter, of the Information desired. Neither Agency intends that a separate request be filed for each document. The Responding Agency shall reply to the Requesting Agency as soon as practical upon receipt of the request.

c) The Agencies may exchange Information relating to the activities of Regulated Persons in order to ensure general awareness of the respective positions taken by the Agencies.

d) The Requesting Agency expressly agrees to limit its use of any Information it receives under this Agreement to functions directly related to the exercise of its lawful jurisdiction.

3. Complaints and Consumer Inquiries

To the extent required or permitted by applicable law or practice, and by the terms of this Agreement:

(i) the KSC shall forward to the designated official at the KID a copy of any written complaint that it receives relating to the insurance activities of a Regulated Person, as appropriate; and

(ii) the KID shall forward to the designated official at the KSC a copy of any written complaint that it receives relating to the securities activities of a Regulated Person, as appropriate.

Complaints shall be forwarded as soon as practical upon receipt of the complaint.

4. Variable Products

a) It is understood and agreed that insurance companies that are KID Regulated Persons are subject to the sole and exclusive jurisdiction of the KID. It is further understood and agreed that broker-dealers, including those broker-dealers that are subsidiaries of insurance companies, are KSC Regulated Persons that are subject to the jurisdiction of the KSC.

b) To avoid any duplication of product registration and of state fees, it is understood and agreed that Variable Products will only be subject to state registration of the product with the KID. It is further agreed that KSC will not seek or require notice filing fees for Variable Products as long as the KID requires registration of the products.

c) To avoid duplication, conflict, or contradiction in any regulatory examinations, investigations, or enforcement actions involving the offer, sale, or investment advice regarding a Variable Product, the KID and KSC agree to cooperate and work together, as appropriate, and otherwise to regulate only those functions of a Regulated Person within each Agency's statutory jurisdiction.

5. Enforcement Actions and Orders

The KID shall notify the KSC of any enforcement action taken by the KID against a KSC Regulated Person, and provide a copy of any enforcement order entered in the matter. The KSC shall notify the KID of any enforcement action taken by the KSC against a KID Regulated Person, and provide a copy of any enforcement order entered in the matter. Whenever practical and appropriate, the notification may be given in advance of the enforcement action. Among other methods the Agencies may use to satisfy the requirements of this section, the Agencies may post such notices or copies on their websites.

6. Confidentiality

a) The Requesting Agency shall take all actions reasonably necessary to preserve, protect and maintain all privileges and claims of confidentiality related to Confidential Information received pursuant to this Agreement, in accordance with applicable law.

b) The Requesting Agency shall restrict access to all Confidential Information solely to those persons at the Requesting Agency and their agents under the Requesting Agency's supervision and control (including, but not limited to, outside counsel, consultants or experts) actively involved in the matter or proceeding described in the Requesting Agency's request for Information. The Requesting Agency shall maintain all Confidential Information in a manner designed to protect the confidentiality and ownership of the Information, and shall train all persons given access in the appropriate procedures for maintaining confidentiality.

c) The Requesting Agency acknowledges that all Confidential Information, in whatever form, furnished by the Responding Agency remains the property of the Responding Agency and agrees to take no action, the effect of which would be to limit, waive or jeopardize any

privilege or claim of confidentiality, including the disclosure of such Information to any other state, local, or federal agency, court or legislative body, or any other agency, instrumentality, entity, or person, without the express written permission of the Responding Agency. In the event of termination of this Agreement, the Requesting Agency agrees that the Confidential Information received remains confidential and will continue to be protected under the terms of this Agreement.

d) In the event that the Requesting Agency receives from a third party a request for Confidential Information furnished by the Responding Agency, or in the event the Requesting Agency is served with a subpoena, order, or other process requiring production of such Confidential Information or testimony related thereto, the Requesting Agency shall:

(i) Immediately notify the Responding Agency that production is being sought, and afford the Responding Agency the opportunity to take whatever action it deems appropriate to protect the confidential and/or privileged nature of the Confidential Information, and cooperate fully in preserving and protecting the full scope of all privileges and claims of confidentiality which may apply to such Confidential Information;

(ii) Notify the party seeking production of the Confidential Information that it belongs to the Responding Agency and that requests for release of such Information must be made directly to the Responding Agency, pursuant to any applicable law;

(iii) Make reasonable efforts to resist production of the Confidential Information pending written permission of the Responding Agency, subject to subsection 5(e) hereof; and

(iv) Consent to any application by the Responding Agency to intervene in any action for the purpose of asserting and preserving any privilege(s) and/or claims of confidentiality with respect to the Confidential Information.

e) It is expressly agreed and understood that in the event any court of competent jurisdiction issues an order to compel the Requesting Agency to produce the Confidential Information covered by this Agreement, the Requesting Agency may comply with such order. The Requesting Agency agrees to advise the Responding Agency as promptly as is reasonably possible of such action.

f) No sharing of Information under this Agreement or compulsory disclosure to third parties of Confidential Information exchanged under this Agreement shall be deemed a waiver of any privilege or claim of confidentiality, except as expressly found by a court or judicial authority of competent jurisdiction.

g) No waiver by either party of any breach of any provision of this Agreement shall be deemed to be a continuing waiver of similar breaches in the future or a waiver of breach of any other provision hereof.

7. Preservation of Existing Statutory Authority and Obligations

a) This Agreement shall in no way limit the discretion of the Responding Agency to deny a request for Information or notification, in whole or part, for any reason consistent with Responding Agency's own supervisory interest and obligations, or where prohibited by law.

b) Nothing in this Agreement restricts, enlarges, or otherwise modifies the respective jurisdictions of the Agencies. Neither this Agreement, nor its termination, shall affect the rights and obligations of either Agency under applicable law, or be deemed an interpretation of such law.

c) Neither Agency is liable to the other for the accuracy or timeliness of Information provided pursuant to this Agreement, nor for obtaining, maintaining, or updating any such Information.

8. Miscellaneous

a) Regular Meetings. The KID and the KSC agree to meet quarterly or at regular intervals to exchange information and to discuss any issues regarding this Agreement.

b) Authority to Enter Agreement. Each of the Agencies hereto gives express assurance that under applicable law, it has the authority to comply fully with the use and disclosure limitations and conditions of this Agreement and that it will provide written notification to the other Agency within ten (10) days of any material change to this authority or any violation of this Agreement.

c) Termination. This Agreement may be terminated by either Agency upon thirty (30) days written notice, *provided, however,* that such termination shall not affect the rights and obligations of either Agency with respect to Confidential Information shared pursuant to this Agreement.

d) Severability. The invalidity of any portion of this Agreement shall not affect the remaining valid portions thereof.

e) Entire Agreement. This Agreement supersedes all other agreements or representations, either oral or written, between the Agencies regarding regulatory cooperation. No waiver, alternation or modification of provisions in this Agreement shall be binding unless subsequently made in writing and signed by duly authorized representatives of the Agencies.

f) Designation of Official. As soon as practical after signing this Agreement, the Agencies will advise one another of the appropriate officials to contact for purposes of notices and exchanges of Information covered by this Agreement and will update such Information as appropriate.

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KANSAS INSURANCE COMMISSIONER

_____

Name:
Title:
Date:

KANSAS SECURITIES COMMISSIONER

_____

Name:
Title:
Date:

Elizabeth (Betsy) Rohleder, CLU, ChFC
Registered Principal

Securities America

January 29, 2003

Representative Mike O'Neal
Chair – House Judiciary Committee
oneal@house.st.ks.us
State Capitol 170-W
Topeka KS 66612

RE: Letter of Support for HB2347

Dear Mr O'Neal ,

I am writing **to support HB2347.** I believe that the definition of a security should NOT exclude Variable Annuities. I believe it is good public policy and will protect customers.

Since I am unable to appear in person, this letter may be used and distributed, if appropriate, during testimony at hearings related to this legislation.

I understand the majority of Variable Annuity sales are made in a responsible manner and clients are fully aware of what they are buying and why they are buying. However, I am also aware that when there ARE complaints of sales practices that are not appropriate, there needs to be a regulatory authority able to invoke fines or revoke licenses.

Variable Annuities are part mutual fund (Securities!), part death benefit (Insurance!), part income payment during the payout period (Securities and/or Income, however structured!). They ARE a security from the federal, licensing, and legal standpoints.

So…why aren't variable annuities regulated like mutual funds and other types of securities? The logic escapes me.

In the legislation proposed, regulation by the Securities Commission will be purely functional. The Insurance Commissioner will retain exclusive jurisdiction over the insurance companies issuing variable products. The primary responsibility will still lie with the Insurance Commissioner.

I want to be clear…I am NOT saying that the Securities Commissioner should now regulate the insurance products or companies. For insurance products NOT considered

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securities, I am very comfortable with the current system of oversight and regulation by the Insurance Commissioner.

While they are in the minority (93% of the agents are licensed/registered – only 7% are not), there ARE unscrupulous persons selling Variable Annuities. Consistency is critical in these types of situations. I believe that the Securities Commissioner's office should regulate those activities that involve securities. Customers, in my humble opinion, will be better served and protected when agents who DO have reason to be investigated and cited for fraud or other violations of the securities laws can be removed from doing further securities business with consumers.

I am in favor of this legislation. I believe it strengthens our industry and better protects consumers without adding undue or unfair regulatory requirements on those of us offering Variable Annuities. We will be able to "clean out" the bad folks and protect a good product for those customers needing it.

Thank you for taking your to read and consider all sides of this issue.

Sincerely,

Elizabeth "Betsy" Rohleder

Disclosure Statement:

I am a licensed insurance agent and a registered representative. I am able to sell insurance as well as securities to my customers here 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 I use Securities America Inc as my broker dealer. I am affiliated with Securities America Advisors Inc as an Investment Advisor Representative I a current member of the Northeast Kansas Society of Financial Service Professionals (NEKSFSP). I am also on the board of NEKSFSP).

From: Clayton Financial Services, Inc. [messages@claytonfsi.com]
ent: Friday, February 14, 2003 4:54 PM
o: oneal@house.state.ks.us
Subject: Support of House Bill 2347 - Kansas Uniform Securities Act

Dear Chairman O'Neal:

I am writing to support HB 2347. I think it's very important that variable annuities be properly and fully regulated. Prior exemption from the definition of "security" is a large
loophole.

As a Registered Investment Advisor (SEC registered), I see tremendous pain inflicted on elderly Kansas residents as the result of the purchase of an inappropriate variable annuity.
Variable annuities are complex and depending upon the sub-account chosen as the investment,
driven by the performance of stock market(s). I truly believe that the citizens of Kansas will benefit by the passage of your Bill.

Thank you in advance for the hard work necessary to protect our most vulnerable citizens.

Respectfully,

Randy J. Clayton, CFP®

Clayton Financial Services, Inc.
http://www.ClaytonFSI.com

*Securities and Investment Advisory Services Offered Through Royal Alliance Associates, Inc.
A registered broker-dealer and member NASD/SIPC and Registered Investment Adviser.
>

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Barry D. Estell
ATTORNEY AT LAW
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February 14, 2003

Chairman Mike O'Neal
House Judiciary Committee
State Capitol
300 SW 10th Avenue
Topeka, KS 66612

Re: House Bill 2347, Kansas Uniform Securities Act

Dear Representative O'Neal:

I urge you and your committee to bring some uniformity and common sense to securities regulation by including variable annuities in the definition of securities under Sect. 2 of the Uniform Securities Act.

I practice law in the area of securities regulation and arbitration. I primarily represent public customers against securities brokerage firms, but I am also a shareholder and director of a regional securities brokerage firm. I can tell you that from either perspective, a variable annuity should be considered a security under Kansas law. As I'm sure you know, variable annuities (a mutual fund wrapped inside an insurance policy) are considered a security under all federal laws and regulation. They are regulated under the rules of the Securities Exchange Commission and the self-regulatory National Association of Securities Dealers. Only in states with obsolete securities laws are these products not securities.

It is important that state laws be uniform as well as consistent with federal law. Inconsistencies between federal and state law can only foster confusion and misunderstanding for both the salesman and the customer. This confusion also offers opportunity for the less ethical vendors of investment opportunities to the further detriment of the vast majority of honest insurance agents, securities brokers and their customers. The uniform act provides a simple solution to a regulatory problem. By providing functional regulation of mutual funds, however they are packaged, the interest of all Kansans will be served.

Yours truly,

Barry D. Estell

Barry D. Estell

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From: Tim Gottschalk [tgottschalk@gottschalkcpas.com]
Sent: Sunday, February 16, 2003 11:05 AM
To: Mike Oneal
Cc: Brant, David
Subject: House Bill 2347 - Kansas Uniform Secruities Act

Dear Honorable Chairman Mike O'Neal,

Based upon my twenty-nine (29) years of professional experience, I believe House Bill 2347 is good legislation. It is good legislation primarily for Kansas citizens. It is important that the definition of "security" include variable annuities. I've seen a number of cases where the "investor" did not understand and/or was not informed about how their annuity would "work" for them. It is only when they start to receive their statements that they realize they may be in for the ride of their life. Furthermore, it is at that time they also discover the tremendous "penalty" they may be charged with if they want to change their investment vehicle. This legislation should result in positive information that will only benefit all Kansas investors.

Please be advised I fully support House Bill 2347 and hope you and your committee will do all possible to accomplish its passing for the benefit of all Kansans. If there is anything I can do to assist you further in this cause, please do not hesitate to call on me.

Thank you kindly for your attention to this matter.

Very truly yours,

Timothy E. Gottschalk, CPA, PFS
GOTTSCHALK & COMPANY, CPA'S, LLC
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Belleville, KS 66935
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tgottschalk@gottschalkcpas.com

From: Jack Rosenfield [jackrosenfield@earthlink.net]
Sent: Tuesday, February 18, 2003 9:04 AM
To: Brant, David
Subject: RE: House Bill 2347

The Honorable Mike O'Neal
Kansas House Judiciary

Dear Chairman O'Neal:

I write today in support of House Bill 2347, in particular that section which would include variable annuities within the meaning of securities.

For background purposes, I retired recently after a 36 year-plus career in the securities industry. Thirty of those years was with the National Association of Securities Dealers (nka/NASDR) from which I retired as Vice President and District Director of their Kansas City, MO. mid-west regional office, a position I held for my last twenty years with that organization. In that role I had the opportunity and pleasure to interact on many occasions with the Kansas Office of Securities Commissioner. It was not unusual for me to personally seek out their assistance in those cases where either because of their particular expertise or demographics, Kansas' investors would best be served by the direct and timely involvement of the Commissioner's staff. In all such instances the citizens of Kansas were well served. Except, that is, in instances where the subject matter of investors' claims involved alleged wrongful sales practices concerning variable annuities.

The reason for the exception was that the Commissioner's staff was severely limited in the scope of their potential involvement because the product in question was not one where they shared the same authority as had existed at the Securities and Exchange Commission and at the NASDR since approximately the early 1970's. For the state of Kansas to continue to deny Kansas citizens the same protections already enjoyed nationally at a federal level is a void that appears ready to be remedied.

I applaud the state of Kansas for now moving forward with this important legislation, and if you feel it would be helpful, I would be pleased to make myself available to discuss further my background and history with respect to this issue.

Sincerely,

Jack Rosenfield
Res: 913-451-2177
Cell:913-645-6479
jackrosenfield@earthlink.net

From: Kenneth Wasserman [kww@nwjklaw.com]
Sent: Tuesday, February 18, 2003 4:25 PM
To: oneal@house.st.ks.us
Cc: Brant, David; loyd@house.st.ks.us
Subject: House Bill 2347/Kansas Uniform Securities Act

Dear Rep. O'Neal:

I am writing to express to you my support of the above-referenced Bill. A significant part of my law practice is estate planning for the elderly, and I am continually shocked at how little many of my clients know about their variable annuities and how poorly those annuities have performed for them. I think, for the benefit of all Kansas citizens, it is imperative that the Kansas Uniform Securities Act conform to federal law and the treatment of variable annuities as securities.

My hope is that this Bill will pass without undue delay and, certainly, I will consider it to be of extreme benefit to a large number of my clients and others across the State of Kansas, if and when the Bill becomes law.

Thank you for introducing the Bill. If I can be of any assistance in either supporting the Bill or assisting in its passage, please do not hesitate to contact me. You may distribute this letter to any members of your committee and to anyone else you deem appropriate during testimony at the upcoming hearing.

Very Truly Yours,

Kenneth W. Wasserman

James W. Parrish
Attorney at Law

Jayhawk Tower
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February 18, 2003

Hand Delivered

The Honorable Rep. Mike O'Neal
Chairman, House Judiciary Committee
State Capitol, Room 170-W
Topeka, KS 66612

Dear Chairman O'Neal:

This letter is written in support of House Bill 2347 which contains the Uniform Securities Act with slight modifications for use in Kansas.

My familiarity with the Kansas Securities Act comes from my service as Kansas Securities Commissioner from 1991 to 1995. Since then I have served as a member of the Securities Commissioner's Advisory Council which works with the Commissioner and his staff to review proposed legislation, administrative rules and regulations and other related matters. Commissioner Brant has appointed me and others to serve as a "drafting committee" to review the Uniform Act and the Kansas amendments that have been suggested to it.

Also, while I endorse the entire bill wholeheartedly, I wish to specifically endorse the provision which conforms state law to federal law in treating variable annuities as securities. This new provision fills a regulatory gap by giving the Commissioner the ability to address abuses in the marketing and sale of variable annuities. This provision will not hinder the activities of honest insurance and securities agents and will provide a needed tool to help protect investors.

I am aware of your work and that of Sen. Vratil as commissioner of the National Conference of Commissioners on Uniform State Laws ("NCCUSL") to finalize the Uniform Act. I appreciate your sponsorship of House Bill 2347, and I ask you to convey to members of the Judiciary Committee my endorsement of this important legislation.

Most sincerely,

James W. Parrish

JWP:tap
pc: Sen. John L. Vratil
Commissioner David Brant
File

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THE NYGAARD LAW FIRM

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Licensed in Kansas, Missouri and Colorado*
Licensed in Kansas and Missouri**

February 18, 2003

VIA ELECTRONIC MAIL
Rep. Mike O'Neal, Chairman
State Capitol
300 SW 10th Ave.
Topeka, KS 66612

RE: House Bill 2347

Dear Representative O'Neal:

I am writing in support of the language of House Bill 2347, which will change the definition of "security" to" not exclude" variable annuities.

Misconduct by several brokers, insurance agents, and "financial planners" have plundered the life savings of early retirees by selling them variable annuities. We are representing many Kansans who retired early due to the misrepresentations made to them by unknowledgeable or unsupervised brokers.

Most of our clients worked for more than 30 years for the AT&T, Hallmark or a utility company in their hometown. They have only high school degrees and virtually no investment experience. Two to three years ago, when the clients were in their early to mid 50's, they were offered early retirement. By assuring the clients that they could withdraw "dividends" of 9 to 10% a year, never invade the principal, and see the principal double or triple in the next few years, brokers convinced the clients to retire and take the lump sum pay-out. The brokers gave them projections and sales materials that were highly misleading, mathematically inaccurate, understated the risks involved, and relied upon wildly unrealistic returns. The clients relied on these representations, retired, accepted the lump sum payment and opened IRA accounts, according to their pending claims.

Contrary to the clients' stated investment objectives; however, all of their retirement funds were invested in variable annuities and the "sub accounts" were invested in speculative technology and growth stocks. As a result, much of their life savings is gone, leaving them with no job, no monthly pension payments, no income,

and little remaining of their one-time lump sum payments. The loss has left the clients financially and emotionally devastated.

The clients' ages, level of education, limited work skills and the current economy make it extremely unlikely that the clients will be able to find employment comparable to that they gave up. Most are struggling just to keep their homes.

As Kansas law currently stands, only the insurance commissioner has jurisdiction over such sales. However, variable annuities are generally considered by the securities bar to be "securities". As such, their sale should be subject to the licensing, suitability and supervision rules and regulations that apply to the sales of securities. As a source of continuing broker misconduct, variable annuities need to be tightly regulated. In addition, given the numbers of defrauded investors and the millions of dollars that have been lost, we believe that it is important that the Kansas securities office, which is aware of these fraudulent sales practices, have jurisdiction to sanction such offending brokers and brokerage firms.

The Kansas Securities Commission has the expertise, competence and resources necessary to protect Kansans from such fraudulent sales practices. I urge the legislature to expand the definition of "security" to better protect investors in this state.

Sincerely,

Diane A. Nygaard

cc: David Brant

NORTH AMERICAN SECURITIES ADMINISTRATORS ASSOCIATION, INC.

NASAA

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Functional Regulation in the 21st Century:

What's Reasonable for Investor Protection and for Agents Selling Variable Annuities?

Updated January 10, 2003

If complaints about an agent's sale of "ABC" mutual fund are handled by the state securities commissioner... Why should complaints about the same agent's sale of a variable annuity invested in "ABC" mutual fund be exclusively handled by the state insurance commissioner?

Are state laws enacted 35 years ago still relevant today when most agents who sell variable annuities are also licensed to sell mutual funds?

These questions and others are being discussed within the context of functional regulation and its application to agents who sell variable annuities and variable life insurance. The National Conference of Commissioners on Uniform State Laws (NCCUSL) has drafted the new Uniform Securities Act (2002) which allows the option to define variable products as securities under state law, while exempting such products from state securities registration.

One of the goals of NCCUSL is to make state laws consistent with federal law and to allow the states the option to provide for state functional regulation of agents selling variable products... since variable annuities and variable life insurance are hybrid products that are marketed as investments.

The purpose of this paper is to provide background information about the NCCUSL proposal and to address a number of concerns raised by the insurance industry. The North American Securities Administrators Association (NASAA) has been working with the National Association of Insurance Commissioners (NAIC) to share information and to discuss these issues.

The Evolution of "Functional Regulation"

The collapse of the stock market in 1929 and the ensuing economic hard times of the Great Depression generated a distrust of large, opaque financial institutions exercising unfettered financial discretion in the markets. In addition to stimulating the creation of the Securities and Exchange Commission (SEC) and the passage of the Securities Act of 1933 and the Exchange Act of 1934, these events also resulted in passage of the Banking Act of 1933 (Glass-Steagall). The primary intended effect of Glass-Steagall was to separate commercial banking from investment banking and to prevent misjudgments by the latter again causing the collapse of the former.

So with the creation of the SEC, the enactment of Glass Steagall and the 1945 McCarran-Ferguson Act awarding custody of the insurance industry to the state insurance commissions, our financial institutions had distinct roles to play and each their own band of regulators with expertise and skills to oversee their activities. The U.S. had developed a structure which carved out authorized activities that each industry--banking, insurance and securities--could pursue without the worry of competition from the others, and a friendly regulatory environment wherein at least modest profit seemed almost guaranteed.

After a few decades and another World War, there developed a certain envy among our financial institutions for participation in products and activities from which they were primarily excluded. Banks wanted to offer retail securities accounts to their customers and even harbored secret desires to do underwritings. Broker/dealers wanted to take deposits and create "sweep accounts and money market funds" to cover all investment needs of their customers. And insurance companies wanted into the mutual fund market and set about getting there through the creation of "variable annuities," a hybrid product with predominantly investment-like features.

Competitive pressures also were beginning to squeeze profitability of certain financial players. In the de-regulatory 1970's, sweeping changes were taking place. Banks and savings and loans could suddenly compete on interest rates, and safeness and soundness rules were changed to allow banking institutions greater flexibility as to where they could invest their assets. Culminating on May Day 1975, a nearly decade-long assault by the SEC on fixed brokerage commissions achieved success. Insurance providers were beginning to experience real inroads from the booming mutual fund industry. Amidst all this deregulatory ferment, policy-makers were becoming more enarmoured of the European and Japanese models where there existed much more overlap in function of financial service providers.

In order to secure the perceived competitive benefits of allowing institutions to sell products outside the brightline boxes into which they were placed after the Depression, the concept of "functional regulation," implicit in the early variable annuity cases, came fully into its own.

As the financial services industry cross-diversified, the operative theory was that each player would be able to provide insurance, banking and securities services, but safety would be provided by requiring each specialized function to be regulated by the subject matter expert over that function. The result has been a somewhat chaotic application of the "Be careful what you wish for" admonition.

As could have been predicted, functional regulation was welcomed with more enthusiasm as a theoretical key to gain entry to new product lines and businesses than as an implemented regulatory reality. If functional regulation is a good thing, it should be embraced generally. Industries should not be permitted to choose if and from whom they will tolerate regulation. The issue of whether state securities regulators should be permitted to assert jurisdiction over agents selling variable annuities is a classic example of the resistance of an industry to functional regulation.

Variable annuities <u>are</u> securities. In the typical variable annuity, ninety-eight percent or more of the premium available after expenses and commissions goes toward the purchase of investment products, with .75-1.25% going to pay for a death benefit. Because variable annuities are federally covered securities, they are exempt from state registration. There is agreement that the state securities regulator should not have any jurisdiction over an insurance company.

The emerging issue is the narrow policy question of whether the same person who is licensed federally to sell both mutual funds and variable annuities is subject to state investor protection authority when selling the former but not when selling the latter.

Description of Variable Insurance Products

There are three basic instruments that are called variable insurance products. They are variable annuities, which have drawn the most attention; variable life insurance, in which the cash surrender value and even the death benefit fluctuates with the performance of the underlying investments; and variable universal life which guarantees a death benefit while allowing the cash value of the policy to fluctuate. Variable universal life, as opposed to variable life, clearly separates the investment and insurance elements of the arrangement. Within these three basic structures there are a multitude of variations and nuances distinguishing one product from another. All three varieties of variable contracts have been held to be securities under federal law and should be recognized as such under the Uniform Securities Act. This paper will focus on variable annuities, except where special attention to variable life products is required, but the considerations, which recommend sales practice scrutiny of annuity products by state securities regulators are equally applicable to variable life products.

The variable annuity is a hybrid product, which incorporates an insurance guarantee into an investment package. The product was devised in the early 1950s as a

response to rising inflation and the growth in popularity of mutual funds. Variable annuities can be purchased for a "lump sum" or by making periodic payments over a period of months or years. The investment portion of the premium is typically invested in mutual funds containing equities, bonds or money market instruments. The rate of return for the annuity "varies" with the performance of the funds selected.

Variable annuities differ from mutual funds in three ways. First, they are tax deferred. No taxes are owed until money is withdrawn. Withdrawals are taxed at the ordinary income rate rather than the sometimes lower capital gain rate. Second, with a variable annuity one can choose to "annuitize" the payout to assure payments for the rest of your or another person's life. Finally, there is a death benefit which assures that the value upon death will never be less than the contributions. (Some variations provide for a "stepped-up" benefit to lock in investment results at periodic stages and such annuities charge higher fees for this feature.) There are various accessories which can further dress up the otherwise "plain vanilla" variable annuities. These include attaching other forms of insurance, such as long term care or guaranteed minimum income benefits.

By their nature, variable annuities always provide a lower rate of return than the mutual funds in which they are invested. This is because in addition to the advisory fees and expenses charged by the mutual fund, the purchaser of a variable annuity also bears the "load" or commission paid to the selling agent, administrative fees charged by the insurance company, and a premium for the mortality risk undertaken in providing the death benefit. There are also "surrender" charges if money is withdrawn from a variable annuity within a specified number of years (usually six to ten). This back-end load, which is typically a percentage equal to the duration in years, declines as the surrender period advances.

Legal Theory

There can be no serious argument that, but for an express exclusion from the definition, a variable annuity is a security. This has been the universal holding under federal law, which is identical in its definition of "security" to almost all state laws. The leading case for this proposition is *SEC v. Variable Annuity Life Insurance Company of America,* 359 U.S. 65 (1959) *("VALIC").*

In *VALIC*, the SEC sought to enjoin the sale of unregistered variable annuities, and sought compliance with the Investment Company Act of 1940. Justice Douglas, writing for a plurality of the Supreme Court, held that variable annuities are not "insurance" and are therefore subject to regulation as a security. He states…

> The difficulty is that, absent some guarantee of fixed income, the variable annuity places all the investment risks on the annuitant, none on the company. The holder gets only a *pro rata* share of what the portfolio of equity

> interests reflects - which may be a lot, a little, or nothing. We realize that life insurance is an evolving institution. Common knowledge tells us that the forms have greatly changed even in a generation. And we would not undertake to freeze the concepts of "insurance" or "annuity" into the mold they fitted when these Federal Acts were passed. But we conclude that the concept of "insurance" involves some investment risk-taking on the part of the company. **The risk of mortality, assumed here, gives these variable annuities an aspect of insurance. Yet it is apparent, not real; superficial, not substantial**. In hard reality the issuer of a variable annuity that has no element of a fixed return assumes no true risk in the insurance sense. (Emphasis added)

While the Douglas opinion is not specific as to which exemplar of a security an annuity contract represents, he does, in a footnote, reference the definition of investment contract contained in the *Howey* case. Justice Brennan, in a concurring opinion, likened the contract to an investment trust.

The Supreme Court had a subsequent opportunity to analyze variable annuity contracts in *SEC v. United Benefit Life Ins. Co.*, 387 U.S. 202 (1967). Here the company had carefully drafted the annuity to include an increased level of risk to the company in order to address the holding in *VALIC*. The SEC again brought suit to enjoin the unregistered offering of the company's "Flexible Fund Annuity" and to require the insurance company to register the flexible fund itself as an investment company pursuant to the Investment Company Act of 1940.

The flexible fund annuity offered by United Benefit combined a fixed-payment annuity with a variable annuity in a single contract. The SEC urged that the variable portion of the contract constituted a security and should be treated as such, separately from the insurance portion of the contract. "The District Court held that the guarantee of a fixed-payment annuity of a substantial amount gave the entire contract the character of insurance." 387 U.S. at 206.

The Court of Appeals, in affirming, rejected the SEC's "fragmentation" theory and read *VALIC* to require only "...that a company must bear a substantial part of the investment risk associated with the contract in order to qualify its products as insurance." *SEC v. United Benefit Life Ins. Co.,* 359 F. 2d 619, 622 (D.C. Cir. 1966).

The Supreme Court, per Justice Harlan, stated "[w]e do not agree with the Court of Appeals that the 'Flexible Fund' contract must be characterized in its entirety. Two entirely distinct promises are included in the contract and their operation is separated at a fixed point in time." 387 U.S. at 207. The Court unanimously agreed with the SEC and reversed, declaring that the Circuit Court viewed *VALIC* too narrowly. Under *VALIC*, the Court held that for purposes of the Securities Act, these contracts are to be considered nonexempt securities and cannot be offered to the public absent registration.

A final Supreme Court case deserving attention is *Nations Bank of North Carolina, N.A. v. Variable Annuity Life Ins.Co.*, 513 U.S. 251 (1995). In this case, known as "*VALIC II*", the Court upheld the ruling of the Comptroller of the Currency, that for purposes of interpreting certain banking preclusions in the National Bank Act prohibiting banks selling insurance, annuities are reasonably classified as investments rather than insurance. The Court, per Justice Ginsburg, also noted in dicta that "[t]reatment of annuities under state law, however is contextual." She went on to observe "[b]ut in diverse settings, states have resisted lump classification of annuities as insurance." See, e.g., *In re New York State Ass'n of Life Underwriters, Inc. v. New York State Banking Dept.*, 83 N.Y.2d 353, 363, 610 N.Y.S.2d 470, 475, 632 N.E.2d 876, 881 (1994) (rejecting "assertion that annuities are insurance which [state-chartered] banks are not authorized to sell," even though state insurance law "includes 'annuities' in its description of 'kinds of insurance authorized' "); *In re Estate of Rhode,* 197 Misc. 232, 237, 94 N.Y.S.2d 406, 411 (Surr. Ct. 1949) (annuity contracts do not qualify for New York estate tax exemption applicable to insurance); *Commonwealth v. Metropolitan Life Ins. Co.,* 254 Pa. 510, 513-516, 98 A. 1072 (1916) (annuities are not insurance for purposes of tax that insurance companies pay on insurance premiums received within the State); *State ex rel. Equitable Life Assurance Soc. of United States v. Ham*, 54 Wyo. 148, 159, 88 P.2d 484, 488 (1939) (same).

Appeals Court Cases

In an important ruling, foreshadowing the rhetoric of functional regulation, the Third Circuit held in *Prudential Insurance Company of America v. SEC*, 326 F.2d 383 (1964), that the fund created by the sale of variable annuity contracts, and not Prudential, was the issuer of the securities for the purposes of the Investment Company Act of 1940 and that registration would be required under the Act, just as it would be for a mutual fund.

Grainger v. State Sec. Life Ins. Co., 547 F.2d 303 (1977), is important because it steps forward from *VALIC* and *United Benefit* and their substantial risk standard, and applies a *Joiner Leasing*, 320 U.S. 744 (1943), analysis to look at all the circumstances of the sale, including sales materials and advertising, in determining whether an annuity contract is a security.

A final, recent case is worthy of note, since, by its holding, states are preempted from registering an annuity as a security, even if they are inclined to do so. In *Lander v. Hartford Life Annuity Ins.*, 251 F.3d 101 (2nd Cir. 2001), it was held that variable annuities are "covered securities" as defined by the Securities Litigation Uniform Standards Act of 1998 (SLUSA). This definition, which is identical to Section 18b of the Securities Act of 1933 as amended by the National Securities Markets Improvement Act of 1996 (NSMIA), defines "covered securities" to include mutual funds and variable products. The operative effect of this holding is that industry's fear that states might wish to assert registration jurisdiction over these products is unfounded.

Uniform Act Treatment of Variable Annuities

The Uniform Securities Act, as Professor Louis Loss drafted it in 1956, did not exclude variable annuities from the definition of "security." The exclusionary language as originally adopted by NCCUSL read as follows:

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

In his comment, Professor Loss states:

> Last sentence: A comparable provision is found in either the definitional or the exemptive provisions of approximately fifteen statutes. Section 3(a)(8) of the Securities Act of 1933 exempts from registration any "insurance or endowment policy or annuity contract or optional annuity contract" issued by a properly supervised corporation, but the SEC has considered this to be a supererogatory on the ground that insurance policies and annuity contracts are not securities anyway. Consequently, the SEC has not attempted to apply the fraud provisions by negative implication from the fact that the federal draftsmen placed the exclusion among the exempted transactions rather than in the definition of "security." A number of courts have similarly held that traditional annuity policies are not securities under the blue sky laws even when they are not specifically excluded. *Haberman v. Equitable Life Assurance Society*, 224 F. 2d 401 (5th Cir. 1955), corrected on rehearing, 225 F. 2d 837 (1955), cert. denied, 350 U.S. 948 (1956) (Texas blue sky law); see also *Hamilton v. Pennsylvania Mutual Life Insurance Co.*, 196 Miss. 345, 17 So.2d 278 (1944); *Rinn v. New York Life Insurance Co.*, 89 F. 2d 924 (7th Cir. 1937); *Bates v. Equitable Life Assurance Society*, 206 Minn. 482, 288 N. W. 834 (1939). The last sentence of Section 401(1) has been explicitly phrased so as not to exclude from the definition the so-called "variable annuities" which have recently been developed. This is consistent with the view expressed in a recent report of the Variable Annuities Committee of the NASAA. See also the comment under Section 402(a)(5).

In 1958, the National Conference had a change of heart, no doubt prompted by intense lobbying of the life insurance industry, and changed Loss' original language to:

> "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 Official Comment to this proposed change of language was: "if it is desired to exclude variable annuities on the ground that the former are sufficiently regulated by the insurance authorities in the particular state, the bracketed language should be deleted."

NCCUSL returned to Loss' original formulation in 1985 with the drafting of the Revised Uniform Securities Act. The language in that Act states:

> (i) an 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 Uniform Securities Act (2002) was approved by the NCCUSL Commissioners at their Annual Conference held July 26 – August 2, 2002, and a copy of the entire act can be found at www.nccusl.org. The definition of "security" is found in section 102(28) and the exclusion for insurance products is written as follows:

> "Security"
>
> (B) does not include an insurance or endowment policy or annuity contract under which an insurance company promises to pay a fixed [or variable] sum of money either in a lump sum or periodically for life or other specified period;

The definition provides that variable insurance products are securities and that fixed products are excluded from the definition. This is accomplished by removing the brackets and the words "or variable", thereby making the definition consistent with federal law. The definition allows the option to exclude variable products, in addition to fixed products, if the brackets are removed and the words "or variable" are included in the text.

According to a survey compiled by NASAA (attached as Exhibit A), there are currently 17 jurisdictions that do not exclude variable annuities from the definition of "security". The state of Washington became the eighth jurisdiction on March 22, 2002 to adopt the "fixed sum of" exclusion which results in variable products being included in the definition of "security". In addition, it appears that eight other states have no exclusion in their definitions and that Hawaii regards variable annuities as securities but does exclude variable life insurance. Thus, NASAA concludes that the states are currently non-uniform with regard to the regulation of agents selling variable products under both state securities and insurance laws.

Support of the Proposal and NASD Actions

The National Association of Securities Dealers (NASD) is supportive of state functional regulation. In a November 2002 letter to a Michigan legislative committee (attached as Exhibit B), NASD President of Regulatory Policy and Oversight Mary Schapiro wrote:

> 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.

In 2001, the NASD announced eight enforcement actions with fines and restitution totaling $254,500 involving marketing, unsuitable sales, and supervision in the sale of variable products. On December 4, 2002, the NASD announced that it censured and fined American Express Financial Advisors, Inc. $350,000 for violations in the sale of variable annuities and variable life insurance products. These cases are the result of a series of special examinations focusing on the sale of variable contracts conducted by NASD Regulation during 1999 and 2000.

Sales of variable products, particularly tax-free exchanges, have increased dramatically over the last several years. To help investors evaluate the factors involving replacement sales, the NASD issued an Investor Alert (available at www.nasd.com) in providing investors with key points to review before replacing a variable product. The NASD has previously offered guidance to its members on the proper sale of variable products through the issuance of Notices to Members 99-35 and 00-44 and an article in the Summer 2000 issue of the *Regulatory and Compliance Alert*.

SEC Complaints and Enforcement Actions

The Securities and Exchange Commission has noted a 45% increase in the number of complaints received regarding variable annuities for the twelve month period ending August 31, 2002. In a letter (attached as Exhibit C), Susan Wyderko, the SEC's Director of Investor Education and Assistance describes the subject of a number of complaints:

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> Many investors appear to not have understood the product they purchased. A number of investors who write, for example, are shocked to learn that the "guarantee" feature of a variable annuity requires them to die. We have received many complaints from older Americans, who did not understand that a variable annuity was a long-term investment, and who need their money returned to them to cover adverse life events.

On January 18, 2002, the SEC announced a settlement in the administrative case of *In re Raymond A. Parkins, Jr.* (SEC Release No. 33-8055). The SEC had alleged that Parkins, an investment adviser and agent registered in Florida, induced his clients to switch variable annuities by providing them with unfounded, false, and misleading justifications for the switches and by misrepresenting or omitting to inform them of the sales charges associated with the switches. As a result of Parkins' fraudulent conduct, his clients incurred unnecessary sales charges of more than $168,000, and in some cases, lost a portion of their investment principal. Parkins received commissions of more than $210,000.

On June 27, 2002, the SEC's San Francisco office announced the filing of civil fraud charges against *Gregory P. Waldon* (SEC Release No. LR17591). The SEC alleges that Waldon, an agent registered in California, recommended 57 switches between 1998 and 2001 in which his customers, most of whom were at least 70 years old and retired, received no economic benefit or lost money and incurred $200,000 in needless transaction costs while Waldon received approximately $275,000 in commissions. The SEC's case is pending.

The SEC has prepared an educational brochure entitled "Variable Annuities: *What You Should Know...*" (available at www.sec.gov) which outlines the factors that investors should consider before purchasing a variable annuity.

Responses to ACLI's Concerns

In August 2001, the American Council of Life Insurers (ACLI) presented to NCCUSL a memorandum of opposition to the inclusion of variable annuities within the definition of security. In their apocalyptic rendering of the damage soon to be visited upon the insurance industry, it is easy to lose sight of what is really at stake here.

At the outset, it should be emphasized again that defining variable annuities as securities will not permit state securities regulators to attempt review or registration of the annuity contract itself. Under NSMIA and the recent *Lander* case interpreting SLUSA, it is clear that the regulation of disclosure and the registration process is exclusively within federal securities jurisdiction.

What the USA (2002) optional language would permit is state securities oversight of agents selling variable products. This is a needed and salutary thing. State securities regulators have been described as the "local cop on the beat." This is because it is to their offices investors can go and tell their stories. The states are best suited to assist "Main Street" investors and they can and do bring smaller cases than the SEC or NASD.

ACLI's concerns are greatly overblown. Let's consider them one by one.

ACLI: The proposed modification to Section 101(w) *conflicts with 47 state insurance codes* that give insurance commissioners *exclusive jurisdiction* to regulate the issuance and sale of variable life insurance and variable annuities.

NASAA: It should be noted that the "exclusive jurisdiction" language in state insurance laws is a related, but separate, issue.

We are not unaware that the ACLI exercises considerable lobbying influence before state legislatures. The statutes referenced by ACLI were enacted almost 35 years ago and ACLI continues to vigorously oppose attempts toward functional regulation. The attached NASAA survey (updated as of 9/3/02) shows that six states and the District of Columbia do not currently have the "exclusive jurisdiction" language in their insurance laws. In addition, the states of South Dakota and Washington specifically recognize the jurisdiction of the state securities administrator to functionally regulate agents selling variable products.

Major economic and regulatory decisions of the past two decades leave the exclusive jurisdiction language with no persuasive underpinning. As we have noted above, the courts have permitted banks and stockbrokers to sell variable annuities. The courts have also made it clear that the McCarran-Ferguson Act does not restrict the ability of the SEC and the NASD to apply their full regulatory authority over variable annuities as they would over any other form of security. And the drumbeat of Gramm-Leach-Bliley reminds us that financial services companies may compete across the board as long as the playing field is made level through functional regulation supplied by the regulator appropriate to each regulated activity.

The National Association of Insurance Commissioners (NAIC) has recently taken very promising steps to advance the increasing cooperation that is occurring between securities and insurance regulators at the state level. In the last three years, insurance and

securities regulators have worked together in many states to coordinate the regulation of viatical settlement contracts.

On November 12, 2001, the NAIC Antifraud Task Force announced the creation of a new subgroup, the NAIC/NASAA Enforcement Coordination Subgroup. The press release announcing the formation quoted Mike Pickens, NAIC President and Arkansas Insurance Commissioner, who chairs the subgroup: "The subgroup's mission, in general, is to increase communication and cooperation between state insurance and securities regulators in an effort to fight fraud and misconduct that can overlap the two regulatory areas. In particular, this new subgroup was created to address improper sales of investment-type products by insurance agents." The NAIC has also expressed interest in sharing enforcement data contained on their new computerized registration system in return for access to the CRD system.

In 2002, the NAIC Life Insurance and Annuities Committee created the Variable Annuities Functional Regulation Working Group to undertake the following charge: "To coordinate with all interested parties to develop a recommendation on functional regulation of agents selling variable products." The NAIC working group is chaired by Lawrence Mirel, the District of Columbia's Commissioner of Insurance and Securities. NASAA has proposed language to amend the NAIC Model Variable Contracts Act that would harmonize and clarify the jurisdiction between insurance and securities regulators over agents selling variable products, which would give effect to the optional language in the Uniform Securities Act (2002) .

Finally, there is an emerging trend observable in state governments to coordinate financial services regulation. The attached NASAA survey shows insurance and securities regulators are part of the same entity or report to the same appointing authority in 13 states and the District of Columbia. The inevitable outcome of this trend is to foster functional regulation. State Insurance Commissioners know that variable annuities are investments. That's why many of them are already working cooperatively with their securities counterparts.

ACLI: The NCCUSL option *contradicts 37 state securities codes* that exclude *all* insurance, endowment and annuity contracts from the definition of "security." The NCCUSL change would create non-uniformity and is currently followed by *only* 8 states.

NASAA: There already is non-uniformity in states securities laws as shown in the attached survey. NASAA agrees that eight jurisdictions have adopted the "fixed sum of" wording in the definition of "security". In addition, it appears that nine other states also have no exclusion in their definitions (see Exhibit A).

It is interesting to note that when faced with this same argument in 1985, NCCUSL decided to go back to Professor Loss' formulation because it was better public policy. If cooperative measures with the NAIC bear fruit, greater uniformity through functional regulation will be achieved in more states.

ACLI: The proposed modification to Sections 101(w) and 201(d) would disrupt a coordinated system of state and federal regulation considered by the U.S. Supreme Court when it addressed the regulatory status of variable life insurance and variable annuities.

NASAA: This is a somewhat mystifying interpretation of *VALIC*. The Supreme Court did not have before it a "coordinated system of state and federal regulation" to consider. The industry, in *VALIC*, was fighting the imposition of just such a system.

It was the interpretations in *VALIC* itself which created the new, prevailing dual system of regulation. Justice Brennan, in his concurrence, goes to considerable lengths to explain away the insurance exclusions in the securities laws. Speaking of the milieu in which those acts were passed, the Justice said, "[a]t this time, of course, the sort of 'Variable Annuity' with which we are concerned did not exist. When Congress made the exclusions provided for in the Acts, it did not make them with the variable annuity contract before it." *VALIC*, 359 U.S. at 75, 76.

The *VALIC* Court was also acutely aware of, and apparently approving of, the dual system of state/federal regulation which then existed over investments. Justice Brennan, again:

> Conversely, of course, however adequately State Securities Commissioners might regulate an investment, it was not for that reason to be freed from federal regulation. Concurrent regulation, then, was contemplated by the Acts as a quite generally prevailing matter. Nor is it rational to assume that Congress thought that *any* business whatsoever regulated by a specific class of officials, the State Insurance Commissioners, would be for that reason so perfectly conducted

> and regulated that all the protections of the Federal Acts would be unnecessary. *VALIC*, 359 U.S. at 75.

It is clear, therefore, that *VALIC* contemplated functional regulation of the sort NASAA endorses for inclusion in the Uniform Act.

One further note, it is interesting that when the insurance industry appears before state legislatures it portrays variable annuities as "insurance". However, when the industry is defending against a class action lawsuit such as the *Lander* case in which the plaintiffs alleged that the marketing of certain variable annuities included "materially false and deceptive" representations, the industry strongly defends variable annuities as "covered securities" so as to be entitled to SLUSA's preemption. The *Lander* decision also concludes that SLUSA is not preempted by the McCarran-Ferguson Act as the "covered securities" designation does not encroach on a state's insurance regulatory regime.

ACLI: The initiative would impose a fourth layer of regulation on variable life insurance and variable annuities on top of comprehensive SEC, NASD, and state insurance regulation. Life insurers marketing group variable contracts also must comply with the ERISA statute administered by the U.S. Department of Labor.

NASAA: This assertion ignores the reality of the effected change. Regulation of insurance companies remains exclusively with state insurance regulators. Registration and regulation of variable products will remain with the SEC and state insurance regulators. The contracts would not be regulated in any fashion by state securities regulators, since NSMIA prohibits it (see the *Lander* decision as discussed above).

ACLI: The proposed modifications to Section 101(w) would cause duplicate regulation of the same product under state insurance *and* securities codes, and would contradict financial services modernization of the Gramm-Leach-Bliley Act.

NASAA: This argument turns GLBA on its head. As early as *VALIC*, the Supreme Court recognized that state insurance regulation is functionally different from the securities regime. Justice Brennan states:

> The regulation of life insurance and annuities by the States proceeded, and still proceeds, on entirely different principles. It seems as

> paternalistic as the Securities Act of 1933 was keyed to free, informed choice. Prescribed contract clauses are ordained legislatively or administratively. Solvency and the adequacy of reserves to meet the company's obligations are supervised by the establishment of permissible categories of investments and through official examination. The system does not depend on disclosure to the public, and, once given this form of regulation and the nature of the "product," it might be difficult in the case of the traditional life insurance or annuity contract to see what the purpose of it would be.

Even today, state insurance regulation emphasizes "safeness and soundness" concepts, with less emphasis on inspections or audits designed to uncover improper conduct by agents. Securities regulators have been enforcing "suitability" standards on their industry since at least the 1960s. While the NAIC has a working group looking into the need for this concept on the insurance side, to date, no such model rule exists.

The fact is that insurance regulators on a day-to-day basis regulate insurance. Sales of variable annuities are not best regulated under insurance principles. That's because, for the most part, variable annuities are not insurance; they are securities. Excluding them from the definition of security under the Uniform Act does not change their basic character nor the kind of functional regulation needed. It merely serves to deprive the public of protections which state securities regulators provide.

Two former state insurance regulators have written a March 11, 2002 letter in support of functional regulation on behalf of the Consumer Federation of America (see Exhibit D). Mr. James H. Hunt, a former Vermont Commissioner of Banking and Insurance, Observed: "If insurance commissioners have ever enforced suitability laws, word has not reached this observer."

ACLI: Variable life insurance and variable annuities are already one of the most heavily regulated financial products in today's broad marketplace. Drawing these products into state securities codes provides no added regulatory value.

NASAA: The product will not be impacted at all. No state can or will attempt to regulate the product because it is a federal covered security and state regulation is pre-empted by NSMIA. To say that

states add no regulatory value arrogantly ignores the quality work the states have done in the enforcement of securities laws for the past 90 years. The NASD's President of Regulatory Policy and Oversight apparently believes the states add value as she has endorsed the USA (2002) approach (see Exhibit B).

State securities and insurance regulators have been working together in recent years to address the problems with viatical settlement contracts and problems with insurance agents selling promissory notes, pay telephones and other unregistered securities. In many cases, insurance regulators have deferred to the state securities regulators to take disciplinary actions against the agents since the problem transactions involved "investment" products.

In recent years, discretion on licensing decisions has typically been more limited on the part of insurance commissioners. For example, NASAA believes that 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. In several cases, agents have been allowed to continue selling variable products after losing their securities license because state insurance regulators have been limited in taking licensing actions unless an agent has a felony conviction.

Hopefully, these "licensing gaps" will be reduced in the future since many states have adopted NAIC's new Uniform Insurance Producers Licensing Act giving insurance regulators more discretion to deny, suspend, and revoke insurance licenses when an agent has "used any fraudulent, coercive, or dishonest practice, or demonstrated any incompetence, untrustworthiness or financial irresponsibility in the conduct of business." However, there is still a concern that lengthy administrative delays can occur before an insurance commissioner can react to an administrative order by a securities regulator. Thus, the most straightforward way to avoid such gaps is through functional regulation.

Clearly, state securities regulators, at a minimum, provide needed resources and expertise to perform more thorough licensing scrutiny and can better respond to customer complaints about suitability and sales practices. The added value is enhanced investor protection.

ACLI: The proposed modifications to Sections 101(w) and 201(d) would create expensive, unnecessary burdens for life insurers and salespersons, and would lead the life insurance industry to oppose

the NCCUSL amendments whenever introduced in state legislatures.

NASAA: As described above, the regulation of insurance companies and variable products will not change.

If variable products are included in the definition of "security" under section 102(28), it should be understood that all insurance company securities are "exempt securities" under section 201(4) of the Uniform Securities Act (2002). Exempt securities, including variable products, are exempt from registration, notice filing and fee requirements of section 302, and the filing of sales literature under section 504 of the Act. Thus, states that adopt the 2002 Act will not require notice filings or fees for variable products.

The only impacted class is the agents. Agents selling variable products are required to be registered with the NASD and with a broker-dealer firm. Because most of the broker-dealers and agents who sell variable annuities also sell mutual funds, they are already required to have state securities licenses.

For example, a December 2001 review by the Kansas Securities Commissioner concludes that 93% of Kansas agents (4,778 of 5,143 with variable insurance licenses) also have a state securities license.

In 2002, the state of Arizona approved a new law, Senate Bill 1107, which clarifies that agents need a state securities license in order to sell variable products.

The vast majority of broker-dealers and agents will experience no additional regulation or fees. In fact, the vast majority of agents selling variable products will never realize that the laws have changed... unless an agent is the subject of a complaint or a regulatory action.

ACLI: The need for the proposed amendments has not been justified or properly explained. A pattern of market conduct has not been identified to warrant these Uniform Securities Act changes.

NASAA: The sales of variable annuities have exploded in the last six years. *The VARDS Report* for the industry shows $138 billion in variable annuity sales and total net assets of almost $1 trillion for the year 2000. Variable annuities are among the highest commissioned products. Great incentive exists to "churn" customers in and out of contracts. The tax aspects of the investment make it unsuitable for

certain kinds of accounts. The USA (2002) option closes a gap in regulation. There may not be a crisis yet, but the storm clouds are gathering. Witness the NASD and the SEC heightened state of alarm over Section 1035 exchanges and "bonus" annuities and the increased level of enforcement over the sales of these products.

ACLI: The amendment principally appears to facilitate expanded state securities revenue and jurisdiction, rather than uniformity and tangible consumer protection.

NASAA: This proposal for functional regulation is not an issue of "regulatory turf" or an attempt to obtain any significant additional fees, as discussed above. State securities agencies are funded by appropriation not expropriation. The suggested statutory changes will have negligible impact, if any, on the variable products industry. The benefits of creating uniformity in the state/federal treatment of variable annuities and in enhancing consumer protection are self-evident.

ACLI: [State legislatures should ignore the optional] changes proposed in Section 101(w) and 201(d), and should retain instead the language currently appearing in Section 401(L) of the Uniform Securities Act (1956). With these suggested corrections, the ACLI and the life insurance industry could support the other Uniform Securities Act amendments implementing commendable uniformity.

NASAA: At what price, honor.

Conclusion

The functional regulation option for the Uniform Securities Act (2002) is a reasonable one, one that was proposed by Professor Loss in 1956 and adopted again in 1985. It does not promote bigger government or unnecessary regulation. The proposal should be supported for the following reasons as discussed above:

- Variable products are "securities" and should be defined the same under both state and federal law;

- The regulation of insurance companies and variable products will not change and the proposal will not be a burden on the industry;

- The vast majority of agents are already dually licensed to sell insurance and securities and will not be affected; and

- Investor Protection will be enhanced with functional regulation.

As so often happens in state legislatures, this may come down to a struggle between what's reasonable and raw political power. Investors in variable products and in mutual funds both deserve the same quality of state protection in the regulation of agents selling these virtually identical forms of investments --- not a disjointed structure devised 35 years ago through the exercise of insurance industry influence. Times and markets have changed... and financial modernization dictates that state regulatory laws, should be modified to cope with the 21st Century.

David Brant
Kansas Securities Commissioner

Royce Griffin
NASAA General Counsel

Attachments

Exhibit A: NASAA State Survey updated as of September 3, 2002

Exhibit B: Letter from NASD Vice-Chairman Mary Schapiro

Exhibit C: Letter from the SEC Director of Investor Education and Assistance

Exhibit D: Letter from the Consumer Federation of America

7-81

UPDATED
9/3/02

NON-UNIFORMITY IN THE FUNCTIONAL REGULATION OF AGENTS SELLING VARIABLE ANNUITIES

Compiled by the NASAA Variable Annuities Project Group

JURISDICTION	DEFINITION OF SECURITY [1] Exclusion or No Exclusion of Variable Annuities	AGENTS [2] Need State Securities License	INSURANCE CODE [3] Jurisdiction Citation	REGULATORY STRUCTURE Securities and Insurance Divisions (Same entity or appointing authority)
Alabama	EXCLUSION [ALA. CODE §8-6-2(10)]	**YES**	§27-38-4	
Alaska	EXCLUSION [ALASKA STAT. §45.55.990 (32)]	NO	§21.42.370(k)	Community & Economic Development
Arizona	**NO EXCLUSION** [ARIZ. REV. STAT. §44-1801(22)]	**YES** [2]	§20-651 (I)	
Arkansas	EXCLUSION [ARK. CODE ANN. §23-42-102 (15)(B)]	NO	§23-81-405	
California	EXCLUSION [CAL. CORP. CODE §25019 (3)]	NO	§10506(h)	
Colorado	EXCLUSION [COLO. REV. STAT. §11-51-201(17)]	NO	§10-7-405 (1)	
Connecticut	EXCLUSION [CONN. GEN. STAT. §36B-3(17)]	NO	§38a-433(c)	
Delaware	EXCLUSION [6 DEL. CODE §7302 (a)(13)]	NO	18 Del. C. §2932(d)	
District of Columbia	**NO EXCLUSION** [D.C. CODE ANN. §31-5601.01(31)(A)]	**YES** [2]	**NONE**	Insurance & Securities Commissioner
Florida	**NO EXCLUSION** [FLA. STAT. §517.021]	**YES**	§627.805	
Georgia	EXCLUSION [GA. CODE ANN. §10-5-2(a)(26)]	NO	§33-11-65(h)	
Hawaii	**NO EXCLUSION** [HAW. REV. STAT. §485-1(13)]	NO	§431:10D-118(d)	Commerce & Consumer Affairs
Idaho	EXCLUSION [IDAHO CODE §30-1402(12) & §30-1434(1)(e)]	NO	§41-1939(1)	
Illinois	**NO EXCLUSION** [ILL. COMP. STAT. §2.1]	NO	215 ILCS §5/245.24	
Indiana	EXCLUSION [IND. CODE §23-2-1-1]	NO	**NONE**	
Iowa	EXCLUSION [IOWA CODE §502.102(19)]	NO	§508A.4	Insurance Commissioner
Kansas	EXCLUSION [KAN. STAT. ANN. §17-1252(j)]	NO	§40-436(1)	
Kentucky	**NO EXCLUSION** [KY. REV. STAT. ANN. §292.310(18)]	NO	§304.15-390(7)	
Louisiana	EXCLUSION [LA. REV. STAT. ANN. § 51:702 (15)(b)(i)]	NO	§1500(J)	
Maine	EXCLUSION [ME. REV. STAT. ANN. §10501(18)]	NO	§2537(11)	Professional & Financial Regulation
Maryland	EXCLUSION [MD. CODE ANN. §11-101(r)(2)	NO	§16-601(b)	
Massachusetts	EXCLUSION [MASS. GEN. LAWS c. 110A §401(k)]	NO	c.175 § 3	
Michigan	EXCLUSION [MICH. COMP. LAWS §451.801(1)]	NO	§500.925, §500.4000	Financial & Insurance Services
Minnesota	EXCLUSION [MINN. STAT. §80A.14(18)(a)(1)]	**YES**	§61A.20	Commerce
Mississippi	EXCLUSION [MISS. CODE ANN. §75-71-105(n)]	NO	§83-7-45	
Missouri	EXCLUSION [MO. REV. STAT. §409.401(o)]	NO	§83-7-45(6)	
Montana	**NO EXCLUSION** [MONT. CODE ANN. §30-10-103(22)(b)]	**YES**	§33-20-602	State Auditor
Nebraska	EXCLUSION [NEB. REV. STAT. §8-1101(15)]	NO	§44-2220	
Nevada	**NO EXCLUSION** [NEV. REV. STAT. §90.295(1)]	**YES**	§688A.390(4)	
New Hampshire	EXCLUSION [NH REV. STAT. ANN. §421-B:2(XX)(a)]	NO	§408:52	
New Jersey	EXCLUSION [N.J. STAT. ANN. §49:3-49(m)]	NO	§17B:28-14	
New Mexico	**NO EXCLUSION** [N.M. STAT. ANN. §58-13B-2x]	NO	§59A-20-30	
New York	**NO EXCLUSION** [N.Y. GEN. BUS. LAW §352(1)]	NO	INSUR. LAW §4240(d)(7)	

Exhibit A

UPDATED
9/3/02

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USDICTION	DEFINITION OF SECURITY [1] Exclusion or No Exclusion of Variable Annuities	AGENTS [2] Need State Securities License	INSURANCE CODE [3] Jurisdiction Citation	REGULATORY STRUCTURE Securities and Insurance Divisions (Same entity or appointing authority)
North Carolina	EXCLUSION [N.C. GEN. STAT. §78A-2(11)]	NO	§58-7-95(r)	
North Dakota	**NO EXCLUSION** [N.D. CENT. CODE §10-04-02(15)]	**YES**	**NONE**	
Ohio	**NO EXCLUSION** [OHIO REV. CODE ANN. §1707.01(B)]	NO	§3911.011(A) and (D)	
Oklahoma	EXCLUSION [71 OKLA. STAT. § 2(w)]	NO	36 0.S. §6061.D	
Oregon	EXCLUSION [OR. REV. STAT. §§59.015 (19)(b)(A)]	NO	ORS 731.046	Consumer & Business Services
Pennsylvania	EXCLUSION [70 P.S. §1-102(t)(iii)]	NO	40 P.S. §506.2(d)	
Puerto Rico	**NO EXCLUSION** [10 L.P.R.A. §881(1)]	**YES**	§1334	
Rhode Island	**NO EXCLUSION** [R.I. GEN. LAWS §7-11-101(20)(i)]	**YES**	§27-32-7	Business Regulation
South Carolina	EXCLUSION [S.C. CODE ANN. §35-1-20 (15)]	NO	§38-67-40	
South Dakota	**NO EXCLUSION** [S.D. CODIFIED LAWS §47-31A-401(m)]	**YES**	**NO see §58-28-31** [3]	Commerce
Tennessee	EXCLUSION [TENN. CODE ANN. 48-2-102(12)(E)]	NO	T.C.A. §56-3-508	Commerce & Insurance
Texas	EXCLUSION [TEX. REV. STAT. ANN. Art. 581-4(A)]	NO	Art. 3.75(8)	
Utah	EXCLUSION [UTAH CODE ANN. §61-1-13(24)(b)(i)]	NO	§31A-5-217.5(6)	
Vermont	**NO EXCLUSION** [VT. STAT. ANN. §4202(a)(16)]	**YES**	§3858	Banking, Insurance & Securities
Virginia	EXCLUSION [VA. CODE ANN. §13.1-501A]	NO	**NONE**	Corporation Commission
Washington	**NO EXCLUSION** [WASH. REV. CODE ANN. §21.20.005(12) **as amended**] [1]	**YES**	**NO see R.C.W. 48.18A.070** [3]	
West Virginia	EXCLUSION [W. VA. CODE ANN. §32-4-401(n)]	NO	§33-13A-4	
Wisconsin	EXCLUSION [WIS. STAT. ANN. §551.02 (13)(b)]	NO	**NONE**	
Wyoming	EXCLUSION [WYO. STAT. ANN. §17-4-113 (a) (xi)]	**YES**	§26-16-502(d)	
TOTAL	**17 of 52 HAVE NO EXCLUSION**	**14 of 52 REQUIRE**	**7 of 52 NOT EXCLUSIVE**	**14 OF 52 RELATED**

[1] A total of 17 jurisdictions do **not** exclude variable annuities from the definition of a "security": 8 jurisdictions (DC, KY, MT, NV, PR, RI, SD, and WA) only exclude contracts which pay "a fixed sum of" which is the bracketed option under the Uniform Securities Act of 1956; 1 state (HI) includes variable annuities but excludes variable life insurance and fixed annuity contracts; 2 states (IL and NM) have no exclusion for any type of insurance, endowment, or annuity contracts; and 6 states (AZ, FL, NY, ND, OH, and VT) have no exclusion of any kind. **In the state of Washington, the definition of security was amended to include variable products by Senate Bill 6483 which was signed into law by the Governor on March 22, 2002.**

[2] All agents selling variable products are required to: 1) be affiliated with a securities broker-dealer firm; 2) be registered with the National Association of Securities Dealers (NASD); 3) have passed the NASD's Series 6 or Series 7 exam; and 4) be licensed with the state insurance department to sell variable insurance products. At least 14 jurisdictions (AL, AZ, DC, FL, MN, MT, NV, ND, PR, RI, SD, VT, WA, and WY) require agents to have a state securities license in order to sell variable products. **In Arizona, a new law, Senate Bill 1107 (was signed by the Governor on May 6, 2002), clarifies that agents need a state securities license in order to sell variable products. In the District of Columbia, the Securities Bureau is preparing a release to be issued in the near future that will provide guidance to issuers of variable products and their sales agents regarding compliance with the requirements.**

Most agents also have a state securities license in order to sell mutual funds or other securities. For example, a review completed by the Kansas Securities Commissioner in December 2001 concludes that 93% of Kansas agents (4,778 of 5,143 with variable insurance licenses) also have a Kansas securities license.

[3] In the late 1960s, many states adopted the NAIC Model Variable Contracts Statute granting "exclusive jurisdiction" over variable products to the Insurance Commissioner. It appears that seven jurisdictions (DC, IN, ND, SD, VA, WA, and WI) do not have the "exclusive jurisdiction" language. The states of South Dakota and Washington specifically recognize the jurisdiction of the securities administrator to regulate agents.

Exhibit A

Mary L. Schapiro
Vice Chairman, NASD
President, Regulatory Policy and Oversight

NASD

Via Federal Express

November 11, 2002

Commissioner Frank M. Fitzgerald
Office of Financial & Insurance Services
State of Michigan
611 West Ottawa Street, 2nd Floor
Lansing, MI 48933

Dear Commissioner Fitzgerald:

I am writing in regard to House Bill No. 6338, which we understand would adopt the Uniform Securities Act in Michigan and include variable annuities and variable life insurance contracts within its coverage.

NASD was established under authority granted by the Securities Exchange Act of 1934, and 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 5,500 securities firms that employ more than 675,000 registered securities professionals.

As you know, variable contracts are hybrid products that combine securities and insurance components. Our experience in regulating our members' sales of variable contracts leads us to strongly support the bill because it provides functional regulation over the sales practices and licensing of agents involved in the sale of variable contracts.

Sales of variable contracts have grown enormously over the past ten years. NASD has found through its examination of member broker/dealers that frequently these contracts 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 contracts over other securities because of their perceived advantages, particularly the potential for tax-deferred growth of a customer's investment. Like other securities, variable contracts present investment risks because of the fluctuation of underlying sub-accounts in which customers' funds are invested. Given the increasing prominence of variable contracts, NASD has stepped up its efforts in this area through focused examinations, guidance to our members, enforcement actions, and Investor Alerts.

Examples of our active engagement in this very important area can be found generally on www.nasdr.com, and include:

- *Notices to Members* 96-86 http://www.nasdr.com/pdf-text/9686ntm.pdf, 99-35 http://www.nasdr.com/pdf-text/9935ntm.pdf and 00-44 http://www.nasdr.com/pdf-text/0044ntm.pdf

- *Regulatory and Compliance Alerts*, Summer 2000 http://www.nasdr.com/rca_summer00.htm and Spring 2002 http://www.nasdr.com/rca_summer02.asp

- NASD cases reported in our press releases of July 8, 1999 (Pruco Securities fined $20 million http://www.nasdr.com/news/pr1999/ne_section99_170.html), February 15, 2001 (NASD files six actions involving marketing and sales of variable annuities, includes fines and restitution of $112 thousand) http://www.nasdr.com/news/pr2001/ne_section01_022.html), December 5, 2001 (NASD files two actions involving variable annuity and life insurance sales, levies fines of $142 thousand) and January 18, 2002 (Tower Square Securities fined $200 thousand, ordered to make restitution of $4.3 million http://www.nasdr.com/news/pr2002/release_02_004.html).

- *Investor Alert: Should You Exchange Your Variable Annuity?* http://www.nasdr.com/alert_annuityexchanges.htm

Based on our experience, we have found that variable contracts' sales-related problems parallel those of mutual funds and other securities. These problems include, among other things, misleading advertising, unsuitable recommendations, switching and churning of customer accounts to increase sales commissions, and the failure to disclose fees and other important characteristics of these contracts. 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 contracts not to be covered by state securities laws.

If you have any questions regarding our position or NASD operations, 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

Mary L. Schapiro
Vice Chairman, NASD
President, Regulatory Policy and Oversight

cc: Tom Selman

Exhibit C

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

OFFICE OF
INVESTOR EDUCATION
AND ASSISTANCE
Director

Phone: (202) 942-7240
Fax: (202) 942-9634
Email: help@sec.gov
www.sec.gov

November 20, 2002

Mr. David Brant
Securities Commissioner
Office of the Securities Commissioner
618 South Kansas Avenue, 2d Floor
Topeka, Kansas 66603-3804

Dear Commissioner Brant:

This letter responds to your recent inquiry as to whether we have any statistics regarding complaints about variable annuities. As you may know, our Office answers complaints and inquiries from investors who contact the SEC. Investors contact us through telephone calls, e-mails and regular letters. We keep statistics concerning the products complained of, the firms involved, and other relevant information, so that we can better target our Enforcement and Inspections resources.

We recently calculated the number of complaints we have received relative to different products that we regulate. In the twelve months ended August 31, 2002, we received approximately 460 complaints from investors regarding variable annuities, which represents an approximately 45% increase over the preceding 12 month period. This is in sharp contrast to the decrease in complaint volume during that same period of time that we saw concerning other products we regulate, such as equities, mutual funds, and options.

The Securities and Exchange Commission sees but a small fraction of investor complaints nationwide. We have found, however, that our complaint statistics are an accurate reflection of developing problems in the securities area. For that reason, I am concerned about the rise in complaints about variable annuities that we are seeing.

The investors who complain to us about their variable annuity purchases generally identify several problems. Many investors appear to not have understood the product they purchased. A number of investors who write, for example, are shocked to learn that the "guarantee" feature of a variable annuity requires them to die. We have received many complaints from older Americans, who did not understand that a variable annuity was a long-term investment, and who need their money returned to them to cover adverse life events. Investors who have subsequently come to understand the features of their variable annuity tell us that they do not believe the variable annuity product was appropriate for their personal situation.

As you may be aware, we have a very helpful brochure concerning variable annuities, which we believe appropriately outlines the factors investors should consider before purchasing a variable annuity. I have enclosed a copy of that brochure with this letter. I have heard from a number of registered representatives of securities firms that they make this brochure available to customers who are contemplating purchase of a variable annuity, in order to make sure the customer is fully aware of the characteristics of the investment. We believe that investors would be better served if more of them were given this kind of brochure at the time they are introduced to variable annuities as an investment choice.

Please let me know if you need any further information in this or any other area.

Sincerely,

Susan Ferris Wyderko
Director

7-87

Consumer Federation of America

March 11, 2002

David Brant, Chair
NASAA Variable Annuities Project Group
State of Kansas
618 S. Kansas Avenue
Topeka, Kansas 66603-3804

Subject: Regulation of Sales of Variable Products

Dear Commissioner Brant:

Thank you for inviting CFA to review the matter of whether state securities commissioners, in states where they do not now have such jurisdiction, should be given authority to aid those who are missold variable annuity contracts and variable life policies. We understand that only a few state security commissioners may hear the complaints of consumers in their states about sales tactics used in the sale of these instruments, which are of course defined as securities under federal law.

We understand that the National Conference of Commissioners on Uniform State Laws (NCCUSL) is considering a new Uniform Securities Act that could effect added protections for buyers of these insurance products that are also securities. We are pleased to support this effort.

The writer, a Fellow of the Society of Actuaries since 1963 and a Member of the American Academy of Actuaries since 1965, for more than 15 years has operated a low cost service evaluating life insurance policies, since 1995 under the auspices of CFA. (A description of the service may be found at www.consumerfed.org/backpage/evaluate_insurance_policy.htm.) In that capacity he has dealt with hundreds of variable life policies and has seen many that seemed unsuitable. These are extraordinarily complex vehicles that almost no one understands well. They are accompanied by an array of charges that are difficult to assess, including rarely disclosed cost of insurance rates that typically exceed, often substantially, market term rates. The effect of surrender charges, which in larger policies can only be described as huge, is poorly understood. While insurance companies must find sales of such policies suitable for buyers, a reviewer of existing contracts is hard pressed to discern any effect of this rule. If insurance commissioners have ever enforced suitability laws, word has not reached this observer.

The writer's variable annuity experience is less that of an expert than that of an expert observer. One cannot discuss variable life insurance without a working knowledge of the variable annuity market. It is well known that extraordinarily high fees accompany sales of variable annuities, with some contracts fetching four to five times the asset charges of the lowest cost variable annuities. There is frequent churning in the market, especially as surrender charges reach or near zero. Litigation is pending regarding the sales of variable annuities within Individual Retirement Accounts. Most recently, in his work as a volunteer tax preparer in an IRS/AARP program, Tax Counseling for the Elderly, the writer encountered a woman whose income was several thousand dollars below the level that required paying federal income taxes, yet she had been rolled out of one variable annuity into another. The transfer was completely unsuitable for her.

The principal objection to the proposal to expand the authority of state securities commissioners to hear consumer complaints about variable sales is that it would add another layer of regulation for insurers to deal with. As has been clearly explained in the documents we have seen, regulation of insurers and of their variable products would not be expanded. And it appears to us that relatively few agents are not now dually licensed. The writer served as Vermont's Commissioner of Banking and Insurance in the late 1960s; that title encompassed securities as well. In both banking regulation, where examinations were conducted jointly with FDIC examiners, and in securities, where duties were shared with the Securities and Exchange Commission, no complaints were heard that the dual regulation was unduly onerous or expensive.

We have read the position of the American Council of Life Insurers, with whom CFA cooperates from time to time in educational projects. We respect ACLI's concern about over-regulation, but we disagree that the effect of the NCCUSL proposal would "create expensive, unnecessary burdens for life insurers and salespersons." Understandably, the ACLI does not dwell on the potential benefits that the limited authority to hear consumer complaints would bring to disaffected buyers of variable life and variable annuities. A more likely outcome would be that a degree of competition in dealing with and publicizing the excesses of industry sales practices would provide more public confidence in purchases of these securities.

Mr. Hunt prepared this CFA position paper. It was shown to Mr. Hunter, recently Texas insurance commissioner, who agreed to add his support.

Respectfully submitted,

J. Robert Hunter

J. Robert Hunter
CFA Director of Insurance

James H. Hunt

James H. Hunt
CFA Life Actuary

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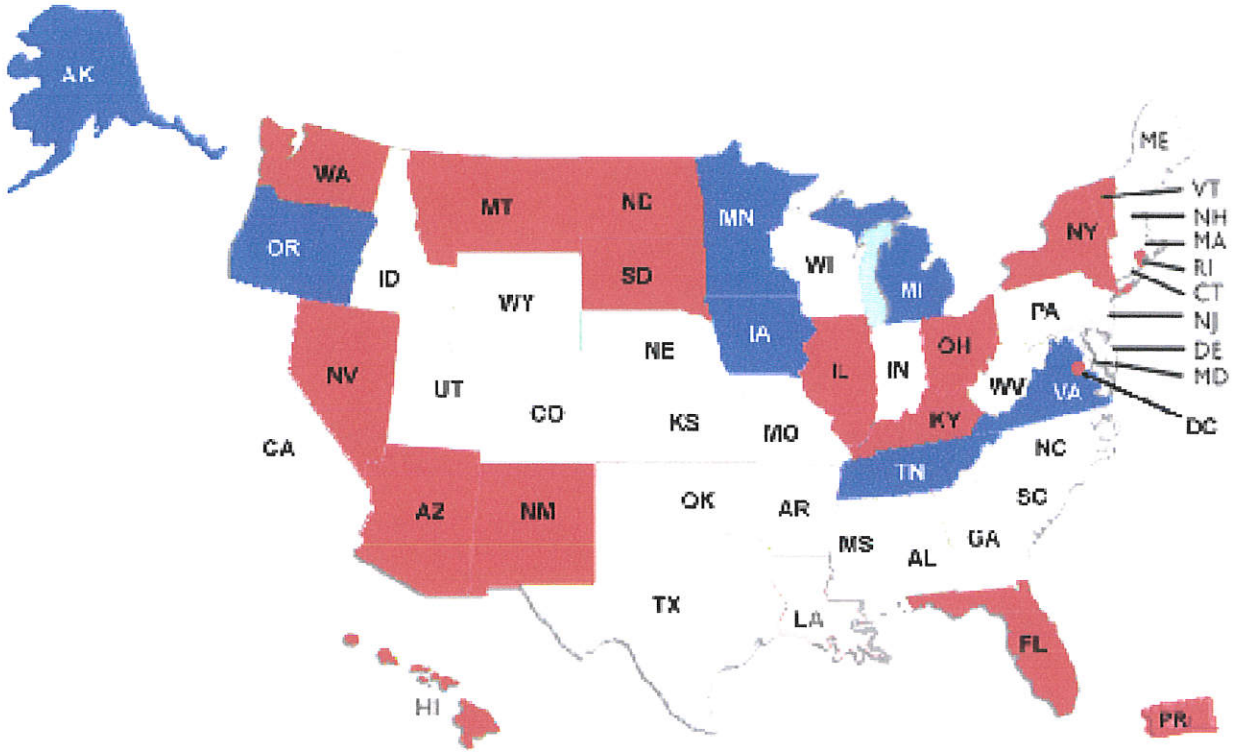

VARIABLE ANNUITIES AND FUNCTIONAL REGULATION

(Based on NASAA Survey updated 9/3/02)

DEFINITION OF SECURITY

USA (2002)	No Exclusion
District of Columbia	Arizona
Kentucky	Florida
Montana	Illinois
Nevada	Hawaii
Puerto Rico	New Mexico
Rhode Island	New York
South Dakota	North Dakota
Washington	Ohio
	Vermont

REGULATORY STRUCTURE

Securities and Insurance Divisions
(Same entity or appointing authority)

Alaska

Iowa

Michigan

Minnesota

Oregon

Tennessee

Virginia

John McCabe

WHY STATES SHOULD ADOPT THE UNIFORM SECURITIES ACT (2002)

The states have a significant role in securities regulation. Fraudulent activity often occurs at a level that eludes the applicability of federal law and, even when federal law applies, eludes the capacity of federal enforcement. Without state regulation accompanied by civil and criminal enforcement of the law in state courts, there would be no hope of redress for many victimized investors.

The Uniform Securities Act (2002) is important new legislation designed to coordinate federal and state securities regulation. It will give states regulatory and enforcement authority that avoids duplication of regulatory effort and blends with federal regulation and enforcement in a more efficient system for investor protection. To that end, the new act provides the following:

- ⇨ **Registration of securities.** Three forms of securities registration - notice, coordination and qualification - clarify and simplify the process for both the regulators and the industry. The requirements give investors assurance that the marketplace will be fair, the playing field level, and the estimations of value based on real information.

- ⇨ **Regulation of broker-dealers, investment advisors, their agents and representatives.** Investment professionals must register in states where they do business. Federal covered investment advisors have notice filing obligations, whereas other investment professionals are subject to more comprehensive registrations. For the most part, securities administrators are authorized to establish these requirements by rule or order.

- ⇨ **Expanded enforcement powers.** Enforcement provisions are more comprehensive and include civil and criminal actions against those who perpetrate frauds through appropriate courts of law and through administrative actions such as cease and desist orders.

- ⇨ **Investigatory and subpoena powers.** Securities administrators will have the power to conduct investigations, backed by subpoena powers and with the contempt powers of a court with jurisdiction.

- ⇨ **Criminal penalties set by states.** The USA 2002 provides that a state sets its own criminal penalties for violations, including for basic anti-fraud provisions. Persons violating the act are subject to civil liability against any injured party. Damages and equitable relief are generally equivalent to those available in actions under federal law.

- ⇨ **Investor education.** The act creates an optional fund to support investor education programs highlighting the need to help investors protect themselves against fraud.

- ⇨ **Electronic filing facilitation**. The act facilitates the electronic filing of documents and the movement toward a more technologically effective system of capital formation and securities regulation.

UNIFORMITY

The Uniform Securities Act (2002) provides enforcement at every level to maximize effectiveness. Its provisions will provide a stronger securities regulatory framework and protections for investors. At the same time, the effort to eliminate duplication of regulation relieves the marketplace of a significant burden, keeping American sec
the world.

H. JUDICIARY
2-19-03
Attachment: 8

Uniform Securities Act

(Last Revised or Amended 2002)

A Summary

Background

The Uniform Law Commissioners have turned to the subject of securities regulation four times in their history. The first act was the Uniform Sales of Securities Act of 1930, which predates the first major federal effort in 1933. The dating of this first act seems appropriate in light of the events of 1929. Recognizing the need for state uniformity, the Uniform Law Commissioners had begun their work eight years earlier, in 1922. There were not many enactments, however.

A second Uniform Securities Act was promulgated by the Uniform Law Commissioners in 1956 to replace the 1930 Act. It was enacted in 37 jurisdictions. The first revision of this mainstay of state securities regulation occurred in 1985; amendments were added to the 1985 Act in 1988, but the revision was enacted in only six states. The Uniform Law Commissioners have now promulgated a fourth Act which replaces both the 1956 and 1985 Acts. It is a carefully balanced result of four years of intensive consideration and drafting, and reflects consensus support from most representatives of the broad array of government and private sector interests that participated in the process. This summary describes the 2002 Uniform Securities Act.

Federal and State Law

Initially it is necessary to recognize that there are two concurrent securities regulatory regimes: one at the federal level and the other at the state level. Federal regulation of securities began effectively with Congress' enactment of the Securities Act of 1933 and the Securities Exchange Act of 1934, which created the Securities and Exchange Commission (SEC). These two Acts, plus the Investment Company and the Investment Adviser Acts enacted in 1940, all of them much amended over the years since their original enactment, are still the core federal law on securities regulation. But there are more federal statutes relevant to securities regulation: Section 103 of the 2002 Act lists a total of 13. From 1956 through 2002, drafters of the successive versions of the Uniform Securities Act have had to deal with the relationship with federal law. Coordinating federal and state regulation has been a substantial objective of the drafters of the new 2002 Uniform Act.

The failure of the 1985 Act to gain many enactments was rooted in the duplication of regulation problem, the role of merit regulation at the state level, and many states' reluctance to address the subject when there was such controversy about its provisions. In 1996, Congress partially resolved this problem in the National Securities Markets Improvements Act of 1996 (NSMIA) and the Securities Litigation Uniform Standards Act of 1998. In NSMIA Congress preempted significant parts of state power to duplicate federal regulation. For example, it prohibits a state from subjecting an offering of "federal covered securities" to merit review and other registration requirements. A principal effort of the 2002 Uniform Act is to reconcile, and to achieve better coordination of, federal and state securities regulation.

State Role in Securities Regulation

The states have an important role in securities regulation. There is fraudulent activity at a level that eludes federal law protection, even when federal law applies. And by no means is every security sold a "federal covered security." Many schemes to defraud investors involve locally generated pyramid schemes, misrepresentation, and scam sales. Without state regulation accompanied by civil and criminal enforcement of the law in state courts, there would be little hope of redress for many victimized investors. State enforcement is also available when there are fraudulent schemes involving federal covered securities. In effect, Congress and the SEC have acknowledged that the federal level is unable to cope with all the enforcement that needs to be done.

The 2002 Uniform Act is an effort to give states regulatory and enforcement authority that minimizes duplication of regulatory resources and that blends with federal regulation and enforcement in a more efficient system for investor protection. Uniformity of law among the states is essential for this to happen, but it needs to be a uniform law that coordinates with federal law.

Elements of Securities Regulation

Securities regulation exists to prevent fraudulent sales of securities to investors. The purpose is achieved by three methods. First, initial public offerings of securities by issuers and control persons must be registered. Second, broker-dealers and their agents, and investment advisers and their representatives, must be registered. Third, fraud in securities transactions must be prohibited and enforcement powers given to an appropriate regulatory agency. These powers include the ability to make rules and regulations, issue stop-orders, bring criminal prosecutions and pursue civil actions in court. The 2002 Uniform Act brings all of this up-to-date with expansion of enforcement authority at the state level.

Registration and Filing for Securities Offerings

There are three methods for dealing with public offerings of securities under the new Act: notice filing, registration by coordination, and registration by qualification.

Notice filing is for certain "federal covered securities". These are securities which by reason of federal preemption are no longer registered at the state level. They include securities that are, or on completion of the offering will be, listed on the New York or American Stock Exchanges, on NASDAQ, or on other exchanges that the SEC approves; or are securities issued by SEC registered investment companies (most of which are the mutual funds); or are securities issued under specified exemptions in the Securities Act of 1933. Public offerings of listed securities and mutual funds, of course, will be registered with the SEC. The notice filing under the 2002 Uniform Act is for federal covered securities other than listed securities, and includes a consent to service of process, payment of a filing fee, and, depending on the state securities administrator's requirements, can include copies of material filed with the SEC as part of registration there. The intent of both NSMIA and the 2002 Uniform Act is to remain essentially revenue neutral as to the states. The Act provides a platform for eventually effectuating one-stop filing whereby documents filed with the SEC can be electronically filed with states within which offerings are to be made.

Offerings of securities that are not federal covered securities must be registered at the state level unless exempt, by means of either coordination or qualification. The provision in the 1956 Act for registration by notification has been eliminated in the 2002 Act, both because it has rarely been used in recent years and because most securities to which it was applicable are now preempted federal covered securities.

Coordination registration at the state level is available for securities that, even though not federal covered securities, are registered with the SEC. These would include securities that do not meet the listing standards of exchanges, which have been going through a process of upgrading. The new Act's registration by coordination provision is little changed from the 1956 Act, which originated it. The objective of the coordination is the simultaneous registration of the offering at the SEC and in the states where the offering is to be made. In order to facilitate the coordination registration process, the state securities administrators association has implemented a system for coordinated review of such an offering by the states in which the offering is to be made. The new Act provides support for that effort. The new Act continues to permit "merit" regulation, which for the limited number of SEC registered issues to which it would apply remains, to that extent, inconsistent with the disclosure basis for SEC registration. A provision of the new Act does require that to the extent practicable any merit standards should be published so as to provide notice. It is hoped that such standards

would be uniform among those states imposing such regulation. A number of states do not apply merit regulation.

Qualification registration at the state level applies to all other offerings being made within a state, for which an exemption is not available. These can include intra-state offerings and offerings that are within exemptions from SEC registration because of their relatively small size. This provision in the new Act, including the required information content of the state registration (which is applicable also to issues being registered by coordination), is little changed from the 1956 Act, except for modernizing language.

The 2002 Act, like the 1956 Act, contains a number of exemptions from the general requirement that all securities offerings must be registered. Some exemptions are for securities, such as government (both U.S. and foreign) and municipal securities, and some are for transactions in securities, such as unsolicited brokerage and limited offering transactions.

Relevant to transaction exemptions is the definition of "institutional investor" in the new Act. It seeks both to make uniform the varied definitions in current state laws and to be consistent under federal law. With respect to securities exemptions, authority is given to the state securities administrator to limit the availability of the exemption for nonprofit organizations securities if debt obligations are being publicly offered. A number of states have been confronted with problems, sometimes of fraud and sometimes simply of inadequate disclosure, in the sale of church bonds.

It is important to recognize that all of these exemptions are only from the registration of securities. They do not free broker-dealers, investment advisers, agents, or investment adviser representatives from the separate registration requirements applicable to them under the Act. In addition, the antifraud provisions of the Act continue to apply to anyone engaging in an exempted transaction or in a transaction involving an exempted security.

Registration of Securities Professionals

The second method of securities regulation is the registration, and continued oversight, of broker-dealers and investment advisers, and the individuals who are agents of broker-dealers or issuers or who are investment adviser representatives, all defined terms in the Act. Here again there is a necessary interaction of federal and state law. The 2002 Act systematizes and reorganizes the provisions dealing with these securities professionals and coordinates them to the extent feasible with federal regulation.

In NSMIA, Congress limited, in certain respects, the state regulation of broker-dealers. In practice most broker-dealers are required under the Securities Exchange Act to be registered with the National Association of Securities Dealers (NASD) and are regulated by both that self-regulatory organization and by the SEC. Nevertheless, under NSMIA and the 2002 Act they are still subject to registration with, and antifraud enforcement by, the states. The individuals who are agents of broker-dealers are also required to be dually registered, and agents of issuers are in general required by the Act to be registered in the states. The new uniform Act clarifies these federal-state interrelationships and promotes an efficient coordination of the duality of registration and regulation in the public interest to the benefit of both the regulators and the regulated.

NSMIA took a somewhat different tack with respect to investment advisers and the individuals who are investment adviser representatives. For investment advisers Congress exercised its constitutional preemptive power to allocate regulatory authority between the SEC and the states. State registration of large investment advisers (those having assets under management in excess of $25 million) was preempted and is exclusively with the SEC. However, under the Act and as permitted by NSMIA notice filings by such "federal covered investment advisers", who must be registered with the SEC, are to be made at the state level, along with payment of filing fees and consents to service of process. Smaller investment advisers (those having assets under management of less than $25 million) are left to exclusive state registration and regulation. The new Uniform Act provides for the notification by larger advisers and the registration of smaller advisers.

The individuals who are investment adviser representatives of both federal covered investment advisers and the investment advisers subject to state registration must be registered with the states in which they do business, unless exempted. There is no system for federal registration of investment adviser representatives, but the NASD is cooperating with the national association of state securities regulators in the creation of a centralized filing system for such representatives. The new Act supports such a system..

There are certain clarifying exclusions from the definitions of broker-dealer, agent, investment adviser, and investment adviser representative and certain exemptions from their registration in the 2002 Uniform Act, which are in general consistent with the federal statutes and with the 1956 Act.

Enforcement

The third method of securities regulation, of course, is enforcement, against anyone for fraudulent practices in securities transactions and against issuers and securities professionals for failure to comply with the registration regimes applicable to them. The new Uniform Act continues the enforcement powers of the state securities regulators contained in the 1956 Act with some enhancements. Enforcement includes civil and criminal actions in the courts and administrative proceedings. The new Act authorizes the state securities administrator to issue, under appropriate procedures, cease and desist orders for violations of the Act, and authorizes courts to enforce such orders. Also contained in the Act are authority for conduct of investigations and issuance of subpoenas and provision of assistance to securities regulators in other jurisdictions The Act also includes civil liability provisions for defrauded persons to obtain damages or rescission that are substantially the same as in the 1956 Act, except that the statute of limitations is lengthened to be the same as the federal statute of limitations for securities fraud liability.

Fraud in connection with securities is a broadly defined term under both federal and state securities law, and the 2002 Act preserves that breadth. In fact, the applicability of the anti-fraud provisions has been expanded by having moved some exclusions from definitions in the 1956 Act to exemptions from registration in the 2002 Act. The antifraud provisions in the Act apply within the state equally to state registered entities and persons, to federal covered investment advisers, and to anyone in connection with transactions in any securities, including federal covered securities.

The definition of "security" largely determines the scope of the Act. The new Act tracks the definition of "security" in federal law, with some additional explicit language to make clear that the Act applies to uncertificated as well as certificated securities, to interests in limited partnerships and limited liability companies, and to investments in viatical settlements of insurance contracts, as to which there has been evidence of abuses. The Act also codifies a generally accepted definition of an "investment contract", a term included in the federal and state definition of "security", for the assistance of state courts. Following federal law, interests in pension plans subject to ERISA are excluded from the definition of "security", as are insurance contracts which are also regulated under other law.

The new Act, as did the 1956 Act, leaves open for resolution state by state whether variable annuity contracts issued by insurance companies should be excluded from the definition of "security". Variable annuities, which operate like and compete with mutual fund investments, are securities under federal law. Because the separate accounts of insurance companies that issue variable annuities would likely be registered

with the SEC as investment companies, they would under NSMIA be federal covered securities not subject to state registration. Including them within the definition of security would have the effect of making their sale subject to the notice filing and antifraud provisions of the 2002 Uniform Act and require agent registration for their sellers.

While not strictly related to enforcement, it is worth noting that the 2002 Uniform Act contains a new provision that would authorize the state securities administrator to develop and implement programs for investor education, with particular emphasis on the prevention and detection of securities fraud. The new Act also creates a Securities Investor Education and Training Fund to support such a program, the funding of which is left to state by state determination. These initiatives are in recognition that financial literacy is increasingly important as participation in the country's equity markets has significantly broadened.

Coordination and Uniformity

In NSMIA, Congress declared that its policy is to increase Federal and State cooperation in securities matters. To implement this, it instructed the SEC, at its discretion, to cooperate, coordinate and share information with state securities regulators so as to maximize effectiveness of securities regulation, maximize uniformity in federal and state regulatory standards, and minimize interference with the business of capital formation, including sharing of information regarding registration or exemption of securities issues and development and maintenance of uniform securities forms and procedures. Congress made it explicit that the policy it enunciated was not intended to be preemptive of state law.

The 2002 Uniform Securities Act responds to this federal initiative by containing a provision that contains a reciprocal instruction, in substantially the same language, from the state legislature to its securities administrator. Thus, upon enactment of the 2002 Act, both the federal and state regulators would have the same marching instructions from their respective legislatures to make securities regulation as efficient, effective and coordinated as practicable in the public interest and for the protection of investors. For this to happen both federal/state coordination and uniformity among the states must be the objectives. The 2002 Uniform Act provides a platform for these to occur at the state level.

National Conference of Commissioners on Uniform State Laws

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Should Variable Annuities Be Included in the Definition of "Security" Under the Uniform Securities Act?

The new Uniform Securities Act (2002) ("USA") makes optional whether to include variable annuities in the definition of "security" or to exclude variable annuities from that definition. Only if variable annuities are included within the definition will state securities administrators be able to regulate the sales of such products. Therefore, the decision of whether to allow state securities administrators to bring enforcement actions concerning variable annuities sales practices will be made on a state-by-state basis. It is one of the most important policy decisions legislators around the country will make when enacting the USA. While many in the insurance industry believe that these investment products should not be "over-regulated", state securities regulators around the country express serious concerns about investor protection for these popular investment products. We agree with the North American Securities Administrators Association who believe that variable products sales practices should be covered by the Uniform Securities Act for the following reasons:

- One of the goals of the Act is to align state and federal law. The United States Supreme Court ruled that a variable annuity is a security in SEC v. Variable Annuity Life Insurance Company of America, 359 U.S. 65 (1959). More recently, it has been confirmed that variable insurance products are "covered securities" as defined in the National Securities and Markets Improvement Act of 1996 and in the Securities Litigation Uniform Standards Act of 1998 (SLUSA), see Lander v. Hartford Life Annuity Ins., 251 F.3d 101 (2nd Cir. 2001).

- The National Association of Securities Dealers supports this type of functional regulation as evidenced by a letter from Mary Schapiro, President for Regulatory Policy and Oversight: "*Based on our experience, we have found that variable products' sales-related problems parallel those of mutual funds and other securities...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.*"

- State securities administrators should be able to bring enforcement actions concerning variable annuities sales practices. Attached is a *Wall Street Journal* article about the disturbing practices of some agents selling variable annuities. The new Uniform Securities Act can provide much-needed additional protection for investors with regard to variable annuities.

H. JUDICIARY
2. 19. 03
Attachment: 9

AMERICAN COUNCIL OF LIFE INSURERS
FINANCIAL SECURITY FOR LIFE

Testimony of

Carl B. Wilkerson, Chief Counsel
Securities & Litigation
American Council of Life Insurers
on
House Bill No. 2347
Before the Judiciary Committee

February 19, 2003

The American Council of Life Insurers greatly appreciates the opportunity to share its views on House Bill No. 2347. Our 399 members represent 72 percent of all United States life insurance companies. 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. 2347, because three aspects of the bill are gravely troubling to life insurance companies:

- By defining variable life insurance and variable annuities as "securities," House Bill No. 2347 would subject these products to the Kansas Securities Code for the first time.[1]

[1]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.

- House Bill No. 2347 would directly conflict with the Kansas Insurance Commissioner's sole and exclusive authority to regulate the issuance and sale of variable life insurance and variable annuities.[2]

- The inclusion of variable life insurance and variable annuities in the definition of "security" was evaluated and rejected by the House Financial Institutions Committee in House Bill No. 2243 (2000) and House Bill No. 2690 (2001). Nothing has occurred to warrant reconsideration of these issues in 2003.

Summary of Position

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

- HB 2347 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.

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[2] *See*, K.A.S. Section 40-436(l) (2002).

- HB 2347 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 2347 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.[3] 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 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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[3] *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 reviews 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. Any deficiencies found by Kansas securities regulators can be efficiently referred to the Kansas Insurance Department for prosecution.

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 Federal Statutes

In 2001, the Kansas Securities Commissioner cited 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. 2347 would establish disfunctional regulation and would thwart financial services modernization.

The current law provides the Insurance Commissioner sole and exclusive jurisdiction to regulate the issuance and sale of variable contracts. By defining variable life insurance and variable annuities as securities, House Bill No. 2347 would establish a direct statutory conflict with the Kansas Insurance Commissioner's exclusive authority. This contradicts the purpose of the Gramm-Leach-Bliley Act, and impairs functional regulatory efficiency.

The Kansas Securities Commissioner also stated in his 2001 testimony that including variable life insurance and variable annuities within the Kansas Securities Code implemented the National Securities Markets Improvements Act of 1996. In truth, Congress enacted this law to prevent the duplicate state and federal regulation of many securities markets professionals and

products. The state and federal securities laws were modernized to prevent duplicate regulation.

Conclusion

House Bill No. 2347 is a solution in search of a problem. Nothing has changed since the House Financial Institutions Committee reviewed and rejected substantially similar bills in 200 and 2001. 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. 2347 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, Section 2(28)(C) of House Bill No. 2347 should be amended as follows.

- The term does not include an 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 other specified period.

Our testimony is supplemented with several compilations of state securities and insurance laws, and with an analysis of the comprehensive scope of state and federal statutes and regulations governing variable life insurance and variable annuities.

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 *All* Insurance, Endowment and Annuity Contracts. Occurs Through Exclusion from the Definition of "Security"**	**Other Parallel Exclusions from State Securities Code**
Alabama	§27-38-4	[1]	§ 8-6-2(10)
Alaska	§21.42.370(k)	§45.55.990 (32)	
Arizona	§20-651 (l)	[2]	
Arkansas	§23-81-405	§23-42-102(15)(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.	§31-4442(f)	[3]	
Florida	§ 627.805	[4]	

[1] 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.

[2] No categories of any kind are excluded from the definition of security in Arizona. [*See*, § 44-1801(26)].

[3] Only fixed insurance, endowment and annuity contracts are excluded from the definition of security in the District of Columbia. [*See*, §31.5601.01(31)(A)].

[4] No categories of any kind are excluded from the definition of security in Florida. [*See*, §517.021(19)].

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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
Georgia	§33-11-65(h)	[5]	
Guam	§12204	§46401(l)	
Hawaii	§431:10D-118(d)	[6]	
Idaho	§41-1939(1)	§30-1402(12)	Bulletin 88-9
Illinois	5/245.24	[7]	
Indiana		§23-2-1-1(k)(1)	
Iowa	§508A.4	§502.102(19)	
Kansas	§40-436(l)	§17-1252(j)	
Kentucky	§304.15-390(7)	[8]	
Louisiana	§1500(J)	[9]	

[5] 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)].

[6] 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)].

[7] No exclusion from the definition of security for any type of insurance, endowment, or annuity contracts in Illinois. [*See*, §2.1].

[8] Only fixed insurance, endowment and annuity contracts are excluded from the definition of security in Kentucky [*See*, §292.310(18)].

[9] Fixed insurance endowment and annuity contracts are excluded from the definition of security in Louisiana. The Louisiana statute also refers to variable annuity contracts in the exclusion from the definition of security. [*See*, §51:702(15)(6)(i)].

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
Maine	§2537(12)	§10501(18)	
Maryland	§16-601(b)	§11-101(r)(2)	
Massachusetts	§132G	§401(k)	
Michigan	§ 500.925, § 500.4000	§451.801(z)	
Minnesota	§§61A.18, 61A.20	§80A.14(18)(a)(l)	
Mississippi	§83-7-45	§75-71-105(n)	
Missouri	§83-7-45(6)	§409.401(o)	
Montana	§33-20-602	[10]	
Nebraska	§44-2220	§8-1101(15)	
Nevada	§ 688A.390(4)	[11]	
New Hampshire	§408:52	§421-B:2(XX)(a)	
New Jersey	§ 17B:28-14	§ 49:3-49(m)	

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

[11] Only fixed insurance, endowment and annuity contracts are excluded from the definition of security in Nevada. [*See*, §90.295(1)].

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
New Mexico	§59A-20-30(E)	[12]	Opinion No. 69-97 Reaffirms Exclusive Authority of Insurance Commissioner and precludes Securities Commissioner jurisdiction
New York	§4240(7)	[13]	
North Carolina	§58-7-95(r)	§78A-2(11)	
North Dakota		[14]	
Ohio	§3911.011(C)	[15]	

[12] No exclusion from the definition of security for any type of insurance, endowment, or annuity contracts in New Mexico. [See, §58-13B-2(X)].

[13] The New York statutes do not specifically define "securities" in a manner similar to other states. Section 352, which grants investigate power to the attorney general, defines security as "…any stocks, bonds, notes, evidences of interest or indebtedness or other securities, including oil and mineral deeds or leases and any interest therein … or negotiable documents of title, or foreign currency orders, calls or options therefore hereinafter called security or securities…." *See* N.Y. Gen. Bus. Law §352(1).

[14] No categories of any kind excluded from definition of security in North Dakota. [*See*, §10-04-02(15)].

[15] No categories of any kind excluded from definition of security in Ohio. [*See,* §1707.01(B)].

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
Oklahoma	§6061(D)[16]	§71-1-2(w)	
Oregon		§59.015(19)(b)(A)	
Pennsylvania	§506.2(d)[17]	§1-102(t)(iii)	
Puerto Rico	§1334[18]	[19]	
Rhode Island	§27-32-7	[20]	
South Carolina	§38-67-40	§35-1-20 (15)	

[16]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."

[17]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."

[18]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."

[19]Only fixed insurance, endowment and annuity contracts are excluded from the definition of security in Puerto Rico. [*See*, §881(1)].

[20][*See*, §7-11-101(20)(i)] Only fixed insurance, endowment and annuity contracts excluded, but §7-11-101(20)(ii) excludes group *variable* contracts subject to ERISA.

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
South Dakota	§58-28-31[21]	[22]	
Tennessee	§56-3-508	§48-2-102(13)(E)	
Texas	Art. 3.75(8)	Art. 581-4(A)	
Utah	§31A-5-217.5(6)	§61-1-13(24)(b)(i)	
Vermont	§3858	[23]	
Virginia		§13.1-501(A)	

[21]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."

[22]Only fixed insurance, endowment and annuity contracts are excluded from the definition of security in South Dakota. [*See*, §47-31A-401(m)].

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

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
Washington	§13.1-501[24]		
West Virginia	§33-13A-4	§32-4-401(n)	
Wisconsin	[25]	§551.02(13)(b)	
Wyoming	§26-16-502(d)	§17-4-113(a)(xi)	

[24]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."

[25]§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.

NUMERICAL SUMMARY OF VARIABLE CONTRACT STATUS CHART	
# of jurisdictions granting Insurance Commissioner *exclusive jurisdiction* to regulate the issuance and sale of variable annuities and variable life insurance contracts	48
# of jurisdictions excluding *all* insurance endowment and annuity contracts from the definition of "Security" in state securities code	34/37[26]
# of jurisdictions *specifically* 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[27]
# of jurisdictions excluding *no* categories of any kind from the definition of "Security" in state securities code	6[28]
# of jurisdictions having *no* exclusion from the definition of "Security" for *any* type of insurance, endowment or annuity contract (i.e., fixed *and* variable insurance, endowment or annuity contracts are defined to be securities).	2[29]

[26]The total of 37 could be used for this category, but needs explanation because in four 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)].
- The 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)].
- The Louisiana statute also refers to variable annuity contracts in the exclusion from the definition of security. [See, §51:702(15)(6)(i)]

[27]These states are: DC, KY, MT, NV, PR, RI, SD and WA. There is a qualification to one state in this category. RI excludes from the definition of security *group* variable contracts subject to ERISA.

[28]These states are: AZ, FL, ND, NY, OH, and VT.

[29]These states are: IL and NM.

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VARIABLE CONTRACTS FULFILL A COMPREHENSIVE STATE AND FEDERAL SYSTEM OF REGULATION

A. STATE INSURANCE REGULATION

Through a network of statutes and regulations, state insurance departments heavily regulate the operations, products, and sales of life insurance companies. Life insurers and their salespersons must satisfy this regulatory structure in their state of domicile and every jurisdiction in which they distribute life insurance and annuities. Uniformity of regulation is accomplished throughout the states by means of model statutes and regulations promulgated by the National Association of Insurance Commissioners (the "NAIC"). Many of the insurance statutes and regulations promulgated and enforced by state insurance departments fulfill regulatory goals quite similar to those of the state securities administrators. The summary below highlights the broad scope and comprehensiveness of certain state insurance statutes and regulations.

UNFAIR TRADE PRACTICES

Virtually every state has enacted a version of the NAIC Model Unfair Trade Fair Practices Act which was developed to regulate trade practices in the insurance business by defining and prohibiting practices that constitute unfair methods of competition or unfair deceptive acts or practices.[30]

A variety of the activities defined to be unfair trade practices directly parallel the purpose and scope of state securities codes. Section 4(A) involves misrepresentations and false advertising of insurance policies, and identifies unfair trade practices to include any estimate, illustration, circular or statement, sales misrepresentation, omission or comparison that misrepresents the benefits, advantages, conditions or terms of any policy, among other things.

Section 4(B) involves false information and advertising generally. This provision defines an unfair trade practice to include making, publishing or disseminating in a newspaper, magazine or other publication, on any radio/television station any assertion, representation or statement about an insurer or its business, which is untrue, deceptive or misleading.

Knowingly making any false statement of any material fact to insurance regulators, or in documents that will be publicly disseminated, is defined to be an unfair trade practice in Section 4(B) of the Model Unfair Trade Practices Act. This proscription is consistent with the

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[30]This model statute governs items previously subject to Section 5 of The Federal Trade Commission Act. Congress observed that continued regulation of insurance by the states was in the public interest. *See*, legislative history of NAIC Unfair Trade Practices Act, NAIC Model Regulation Service at 880-20(1993).

truthfulness and accuracy of reports, records and representations required of Broker/Dealers by the NASD and the SEC under the federal securities laws.

Section 4(J) involves the failure to maintain marketing and performance records, and defines as an unfair trade practice the failure of an insurer to maintain its books, records, documents, and other business records in such an order that data regarding complaints, claims, reading, underwriting and marketing are accessible and retrievable for examination by the insurance commissioner. Data for at least the current calendar year in the two preceding years must be maintained under this standard. This provision directly parallels the scope and purpose of NASD Conduct Rule 3110 regarding books and records.

Section 4(K) defines the failure of any insurer to maintain a complete record of all the complaints it received since the date of its last market conduct examination to be an unfair trade practice. The records of complaints must indicate the total number of complaints, their classification by line of insurance, the nature of each complaint, the disposition of each complaint and the time it took to process each.[31] For purposes of this subsection, the term "complaint" means any written communication primarily expressing a grievance.

Like state securities administrators, insurance commissioners have the power to examine and investigate the affairs of every insurer operating in the insurance department's state "in order to determine whether such insurer has been or is engaged in any unfair trade practice prohibited by [the Unfair Trade Practices Act]."[32] Several provisions embellish this important authority.

For example, Section 7 of the Unfair Trade Practices Act gives insurance commissioners extensive authority to initiate hearings concerning unfair trade practices, to compel witnesses, appearances, production of books, and service of process. Section 7 sets forth detailed administrative and procedural practices, in order to assure due process and quasi-judicial formality.

Section 8 of the Unfair Trade Practices statute authorizes insurance commissioners finding insurers guilty of unfair trade practices to issue written findings and enforcement orders requiring the insurer to cease and desist from engaging in the act or practice. The insurance commissioner also has the discretionary authority to suspend and revoke the insurer's license if the insurer knew or reasonably should have known that its conduct violated the Unfair Trade Practices Act, and to order penalties of $1,000 for each violation up to an aggregate penalty of $100,000, unless the violation was committed flagrantly in conscious disregard of the act, in

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[31]The NAIC has also promulgated a Model Regulation for Complete Records to be maintained pursuant to Section 4(K) of the NAIC Unfair Trade Practices Act. *See*, NAIC Model Regulation Service at 844-1(1992).This regulation sets forth a complaint record form, content requirements, maintenance requirements, and standards concerning the format of complaint records.

[32] *See* Section 6, Power of Commissioner, Model Unfair Trade Practices Act, NAIC Model Regulation Service at 880-9(1993).

which case the penalty may be up to $25,000 for each violation to an aggregate total penalty of $250,000. A similar monetary violation may be imposed under Section 11 for violations of cease and desist orders. The act also provides for judicial review of insurance commissioner orders and authorizes immunity from prosecution for witnesses who attend, testify or produce books, records or other paper correspondence.[33]

These significant powers that may be used by insurance commissioners to enforce violations of unfair trade practice proscriptions, together with the recordkeeping, reporting and inspection powers of the Act, provide a package of regulatory tools directly analogous to state securities codes, the NASD Rules of Conduct and SEC regulations governing market conduct practices and the prosecution of violations. In a sum, the unfair trade practice laws provide meaningful proscriptions that eliminate the need for duplicative regulation of variable contracts.

NAIC Model Fraud Laws and Fraud Legislation

Enactment of state fraud statutes represents another significant insurance regulatory development. Recent market conduct issues have resulted in some insurance departments requiring insurer management to assume increased responsibility for supervision of sales activities. Other states have taken an approach similar to that of New York and Pennsylvania by requiring insurer review of market conduct compliance, thus placing direct responsibility at the corporate officer level. This widespread action dovetails with the objectives of the Federal Crime Control Statute and the Federal Sentencing guidelines, discussed below.

While states have taken different approaches to the issue, the majority of states addressing the fraud issue enacted legislation similar to the NAIC Model Fraud Laws.[34]

Market Conduct Examinations

Nearly every jurisdiction has enacted a version of the NAIC Model Law on Examinations.[35] This Act is designed to provide an effective and efficient system for examining the activities, operations, financial condition and affairs of all persons transacting the business of insurance in each state and concerning individuals otherwise subject to the insurance commissioner's jurisdiction. The Act is intended to enable commissioners to adopt a flexible system of examinations and allocate resources deemed appropriate and necessary for the administration of the insurance laws of each state. The Model Law on Examinations sets forth standards for the conduct of examinations, commissioner authority, scope, and scheduling of examinations. It also details the scope of examination reports which shall be comprised of only

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[33] *See* Sections 8, 9, 10, 11 and 14 of the Model Unfair Trade Practices Act, NAIC Model Regulation Service at 880-10 through 13(1994).

[34] *See* NAIC Insurance Fraud Prevention Model Act, NAIC Model Reporting Service at 680-1(1995).

[35] *See* NAIC Model Regulation Service at 390-1(1991).

facts appearing on books, records or other documents of the company, its agents or other persons examined or as ascertained from the testimony of its officers or agents or other persons examined.[36]

Significantly, this Model Act dovetails with the NAIC Market Conduct Examiner's Handbook, an extremely detailed manual for examiners to assure that examiners follow comprehensive, uniform practices and procedures. The Examiner's Handbook is divided into seven different sections and contains 58 different standards. Among other things, the Examiner's Handbook addresses complaint handling, marketing and sales, producer licensing, and company operations/management.[37]

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[36] *See* Sections 3, 4, and 5 of the Model Law on Examinations, NAIC Model Regulation Service at 390-5 (1991). Section 5 also sets forth detailed provisions for orders and administrative procedures in the conduct of hearing and adoption of a report on examination.

[37] Certain standards under the complaint handling section illuminate the depth and scope of the market conduct examination. Several standards are set forth below in this note as representative examples.

Complaint Handling

Standard 2

The company has adequate complaint handling procedures in place and communicates such procedures to policyholders.

Review Procedures and Criteria

Review manuals to verify complaint procedures exist. Procedures in place should be sufficient to require satisfactory handling of complaints received as well as internal procedures for analysis in areas developing complaints. There should be a method for distribution of and obtaining and recording response to complaints. This method should be sufficient to allow response within the time frame required by state law.

Company should provide a telephone number and address for consumer inquiries.

Complaint Handling

Standard 3

The company should take adequate steps to finalize and dispose of the complaint in accordance with applicable statutes, rules and regulations and contract language.

Review Procedures and Criteria

Review complaints documentation to determine if the company response fully addresses the issues raise. If the company did not properly address/resolve the complaint, the examiner should ask company what corrective action it intends to take.

Commentary:

Reference to the examiner's general instructions on Handbook page VIII-14 (November 1995) reveals that an inquiry broader in scope than the mere resolution of a given complaint is expected. For example, the Handbook contains the following instructions:

"The examiner should review the frequency of similar complaints and be aware of any pattern of specific type of complaints....Should the types of complaints generated be cause for unusual concern, specific measures should be instituted to investigate other areas of the company's operation."

Complaint Handling

Standard 4

The time frame within which the company responds is in accordance with applicable statutes, rules, and regulations.

Review Procedures and Criteria

Throughout most of 1995 and 1996, the NAIC significantly revised the Market Conduct Examiner's Handbook, which has been recommended for full adoption by the NAIC. The NAIC, together with industry input, sought to expand and enhance tools fostering the detection and prevention of marketplace abuse in the life insurance industry. Market conduct examinations are extremely comprehensive and serve as a means of positive reinforcement, by discouraging deficient practices that will be detected on examination, resulting in remedial action, and insurance department intervention.

AGENTS LICENSING AND TESTING

The NAIC Agents and Brokers Licensing Model Act,[38] which appears virtually in every state, governs the qualifications and procedures for licensing insurance and annuity agents and brokers. This model law sets forth examination and licensing standards in great detail, and has a specific category for variable annuities and variable life insurance contracts. Licensed salespeople must be deemed by the insurance commissioner to be competent, trustworthy, financially responsible, and of good personal and business reputation. Insurance brokers must also fulfill experience requirements. Section 8 of this regulation governs license denial, non-renewal and termination, giving the insurance commissioner broad discretion to suspend, revoke or refuse to issue or renew a license upon finding any of a variety of conditions including materially untrue statements, violation or noncompliance with insurance laws, withholding, misappropriating or converting customer moneys, conviction of a felony or misdemeanor involving moral turpitude, forgery, or cheating on licensing examinations, among other things.

CONTINUING EDUCATION

In granting insurance agents and brokers licenses, most states also impose significant continuing education standards that parallel in objective and scope the continuing education standards recently developed by the securities industry together with the NASD. As in other areas seeking uniformity, the NAIC has promulgated the Agents and Brokers Licensing Model Act.[39] Under Section 5 of this model regulation, licensed agents must annually satisfy courses or programs of instruction approved by insurance commissioners in each state according to a minimum number of classroom hours, which typically is in the range of 25 class room hours per year for life and annuity salespersons. The courses include those presented by the Life Underwriter Training Council Life Course Curriculum, the American College's Chartered Life Underwriter and Chartered Financial Planner curriculum, and the Insurance Institute of America's programs in general insurance, for example. Like the NASD, state insurance regulators understand that testing, licensing and demonstration of continued competence through continuing education is critically important in the distribution of insurance and annuity products.

Review complaints to ensure company is maintaining adequate documentation. Determine if the company response is timely. The examiner should refer to state laws for the required time frame.

[38] *See* NAIC Model Regulation Service at 210-1 (1990).

[39] *See* NAIC Model Regulation Service at 215-1 (1990).

VARIABLE CONTRACT STATUTES

Life insurance companies are authorized to issue separate accounts funding variable life insurance and annuity contracts upon fulfilling a variable contract statute in their domestic state, which typically follows the NAIC Model Variable Contract Law.[40] This NAIC model statute gives the insurance commissioner exclusive authority to regulate the issuance and sale of variable contracts and to issue rules and regulations appropriate to carry out the act's purpose. This model act and associated regulations that appear under state insurance law gives an additional, important measure of regulatory scrutiny and purchaser protection.

Collectively, the NAIC statutes and regulations provide a significant network of comprehensive regulation over many important aspects affecting the marketing and sale of variable contracts that closely reflect the purpose and scope of analogous concepts of securities regulation.

INSURANCE PRODUCER DATABASE

From a market conduct perspective, life insurers have committed to a single, industry-accessible national producer database to facilitate their ability to track pertinent information regarding licensed producers. Access to information having a bearing on the producer's background, qualifications and competency is a valuable tool to insurers in the employment/appointment screening process. Moreover, widespread availability of such information makes it more difficult for a producer with significant disciplinary history to continue illegal or unethical practices by "company jumping."

Incorporated in October 1996, the Insurance Regulatory Information Network (IRIN)[41] is a non-profit affiliate of the National Association of Insurance Commissioners (NAIC) that has developed and implemented the Producer Database (PDB). IRIN is governed by a board of directors structured to include five members representing the NAIC and four industry members representing a cross section of the insurance industry.

The PDB is an electronic database consisting of information relating to insurance agents and brokers (producers). The PDB links participating state regulatory licensing systems into one common repository of producer information. The PDB will also access other information sources such as the National Association of Securities Dealers (NASD), the Regulatory Information Retrieval System and others. The PDB also sends an electronic notification to state users if administrative action is taken against a licensed producer in their state or if a producer no longer holds an active resident license. The key benefits of PDB are:

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[40] *See* NAIC Model Regulation Service at 260-1 (1984).

[41] Additional information about IRIN can be obtained at its website http://www.irin.org.

X Immediate access to detailed disciplinary history

X Immediate electronic notification of administrative action

X Verification of licenses and good standing in all participating states

PIN is an electronic communication network that links state insurance regulators with the entities they regulate to facilitate the electronic exchange of producer information. Data standards will be developed for the exchange of license application, license renewal, appointment and termination information. All data flowing over PIN will conform to these standards.

Through the Internet, industry users of the PDB are able to access various types of information regarding producers licensed in participating states, such as demographic information, license status, final disciplinary action taken by a state, certain NASD information if applicable, and letters of certification and clearance.

As of January 22, 1999, producer information from 18 states can be viewed on Internet PDB. These states are AR, CO, CT, FL, IA, IL, IN, MI, MN, NC, ND, NJ, OH, PA, SD, TX, WA, WI. Information provided by North Carolina is currently masked, but should be available by March 1, 1999. All but three states currently provide daily updates. California is expected to begin providing producer information to Internet PDB by the end of the first quarter of 1999, while AZ, DE, ID, KS, KY, LA, NE, NY, TN and VA are in the planning states.

The implementation plan approved by the IRIN Board calls for 38 states to be on the Internet PDB by the lst Quarter of the year 2000. Implementation dates for the remaining states and territories will be set during 1999. IRIN is continuing to provide technical and quality assurance support to the State Licensing and IS departments as they implement a daily update interface to Internet PDB.

In many respects, this new producer data base parallels the purpose and scope of the NASD's Central Records Depository or CRD. Indeed, linkage between the CRD and IRIN exists. Through the IRIN data base, problem producers can be tracked and deterred from the insurance business.

B. ERISA

In several significant regards, the ERISA statute was patterned after the Investment Company Act of 1940 concerning prohibitions against self-dealing, fiduciary duty, and information reporting. As a general standard, employee benefit plans must be operated for the exclusive benefit and solely in the interest of plan participants and beneficiaries. Plan sponsors are subject to high standards of prudence in executing their responsibilities, and are subject to liability for breaches of fiduciary duty that are punishable by severe penalties. Retirement plans funded by variable contract separate accounts must fulfill these rigorous fiduciary and regulatory standards administered by the Department of Labor.

A plan sponsor has a fiduciary duty to select appropriate funding vehicles, such as group variable annuities, and to continually monitor their performance.[42] This responsibility includes a thorough evaluation of the insurance company and the investment manager's experience, and execution of due diligence in ascertaining the manager's good professional character and appropriate licensing. If the fiduciary fails to act prudently and exercise due diligence, the fiduciary is liable to plan participants for any losses attributable to the inexperience of the investment manager.

The problems of churning and inappropriate replacements are circumscribed under ERISA which requires that a fiduciary act solely in the interest and for the exclusive benefit of plan participants and beneficiaries.[43] In addition, ERISA specifically prohibits a fiduciary from dealing with assets of a plan in his/her own interest or for his/her own account.[44]

ERISA prevents any person who has been convicted of certain crimes from serving: as a plan administrator, fiduciary, trustee, custodian or representative in any capacity of any employee benefit plan; as a consultant or advisor to any employee benefit plan; or, in any capacity that involves decision making authority or custody or control of plan assets.[45]

In another example of regulatory parallels, ERISA grants the Labor Department the power, in order to determine whether any person has violated or is about to violate any provision of ERISA or any regulation thereunder, to conduct an investigation, and to require the submission of reports, books, and records, and the filing of data in support of any information required to be filed with the Labor Department. In addition, the Labor Department has the authority to enter business places, inspect books and records, and question persons to enable the Department to determine the facts relative to such investigation.[46] These inspection and examination powers correspond to the authority of securities administrators to examine registered broker/dealers, and ensure regulatory supervision of qualified plan administration.

Similarly, ERISA requires extensive recordkeeping, and mandates that certain plan administrators must furnish to participants an individual statement containing information about each participant's benefits.[47] Additionally, ERISA requires each administrator of a pension plan

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[42]Unlike other suitability standards that are measured only at the time of purchase, ERISA requires plan sponsors to continually monitor the appropriateness of qualified plan funding vehicles. The broad scope of this fiduciary duty is comprehensively discussed in Knickerbocker, *Fiduciary Responsibility Under ERISA* (Michie) (1997).

[43]*Id.* at Sections 404(a).

[44]*Id.* at Section 406(b)(1).

[45]*Id.* at Section 411.

[46]*Id.* at Section 504(a).

[47]*Id.* at Section 105.

to furnish to any plan participant or beneficiary who so requests in writing, a statement indicating, on the basis of the latest available information, the total benefits accrued and the nonforfeitable pension benefits which have accrued or the earliest date on which such benefits will become nonforfeitable.[48]

The fundamental structure of ERISA and state fiduciary laws place the responsibility for the investment of retirement plan assets on plan fiduciaries, who select and monitor institutions managing plan assets and, with respect to 401(k) plans, also assure participant access to a prudent and diverse range of investments for individual accounts. Failure to fulfill these obligations in a prudent manner and solely in the interests of plan participants and beneficiaries subjects the fiduciary to ERISA's enforcement regime.

Under ERISA, a participant, beneficiary or the Secretary of Labor can bring a civil action against the fiduciary who breached his or her duties. The fiduciary is personally liable to make good to the plan any losses resulting from the breach and to restore to the plan any profits that inured to the fiduciary. The fiduciary is also subject to other equitable or remedial relief as a court may deem appropriate.

DOL DISCLOSURE INITIATIVES AFFECTING QUALIFIED PLANS

There have been significant developments at the Department of Labor concerning the range of funding options available to plan participants and the risk attributable to each option, and noteworthy strides in educating plan participants about retirement plan funding alternatives. After careful analysis and critical scrutiny, the Department of Labor issued its Section 404(c)

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[48]Section 103 of ERISA requires plan administrators to engage an independent qualified public accountant to conduct such an examination of a financial statements of the plan, and of other books and records of the plan, as the accountant may deem necessary to enable the accountant to form an opinion as to whether the financial statements and schedules are presented fairly in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding year. This requirement applies to plans covering 100 or more participants, and also mandates that the accountant shall conduct such tests of the books and records of the plan as are considered necessary by the independent qualified public accountant.

Among other things, the annual report required in Section 103 must have information in separate schedules concerning: a statements of the assets and liabilities of the plan aggregated by categories and valued at the current value; a schedule of all assets held for investment purposes aggregated and identified by issuer, borrower or lessor, maturity date in valuation and a schedule of all loans or fixed income obligations.

Section 102(a)(1) requires that the summary plan description for participants and beneficiaries shall be written in a manner calculated to be understood by the average plan participants and shall be sufficiently accurate and comprehensive to reasonably apprize such participants and beneficiaries of their rights and obligations under the plan. This requirement parallels the SEC's plain English initiative. Collectively, these requirements impose high thresholds for monitoring activities involving qualified plans and plan assets, and preventing abusive practices. This parallels SEC and NASD plain English and participant education initiatives.

regulations in 1992 that provide plan participants with useful additional information about, and more control over, their investment choices.[49]

In order to rely on the Section 404(c) regulations, a plan sponsor or plan administrator must offer at least three diversified investment vehicles, each of which has different risk and return characteristics. Further, the plan must permit participants to transfer among the vehicles at least once within each three-month period, and more frequently for investment vehicles subject to fluctuating performance patterns.

Significantly, the Section 404(c) rules require the plan sponsor to assure that plan participants are given, or can obtain, the information necessary to make an informed investment decision. At a minimum, sponsors must give employees information about each investment option, including its objectives, risk and return characteristics, and type of portfolio assets, as well as information about transfer procedures, the expenses and performance of each investment option, and a prospectus for vehicles registered under the Securities Act of 1933.

Since adopting the Section 404(c) regulations concerning fiduciary responsibilities for self-directed individual account plans, the Department of Labor issued Interpretative Bulletin 96-1 on June 6, 1996, which provides guidance to encourage employer-provided education for plan participants. The Department of Labor sought to provide a safe harbor for retirement plans delineating the type of investor education that could be provided to plan participants without becoming investment advice. The Department of Labor issued this interpretation in view of the important role that investment education can play in assisting participants and beneficiaries in making informed investment and retirement-related decisions.

Interpretative Bulletin 96-1 identifies four increasingly specific categories of investment information and materials that can be provided within the ambit of investment education. These are plan information, general financial and investment information, asset allocation models, and interactive investment materials. This category includes information and materials that inform a plan participant or beneficiary about (i) general financial and investment concepts, such as risk and return, diversification, dollar cost averaging, compound returns and tax-deferred investment; (ii) historic differences in rates of return between different asset classes (*e.g.,* equities, bonds or cash) based on standard market indices; (iii) the effects of inflation; (iv) how to estimate future retirement income needs; (v) how to determine investment time horizons; and (vi) how to assess risk tolerance.

In October 1998, the Department of Labor published a detailed consumer disclosure booklet on 401(k) plan fees.[50] This Department of Labor action evidences active regulation of qualified plan funding vehicles.

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[49]Section 404(c) under ERISA gives plan sponsors or plan administrators of self-directed plans protection from certain fiduciary liabilities if the conditions of Section 404(c) are followed.

C. OTHER FEDERAL STATUTES ENHANCING COMPLIANCE PROCEDURES AND MARKET CONDUCT

The *Federal Violent Crime Control Act of 1994* ("The Act"), and the *Federal Sentencing Guidelines for Organizations* have an important impact on the prevention of abusive sales practices. Together, these statutes provide material protections for qualified plans and their participants.

Several provisions in the *Federal Violent Crime Control Act of 1994*[51] relate to sales practices within the insurance industry. The law punishes with fines and a jail term up to five years anyone who *participates* in the business of insurance and has been convicted of a felony involving dishonestly or a breach of trust. Likewise anyone convicted of violating the Act itself cannot participate in the business of insurance and is punished with fines and jail. There are fines and jail terms for anyone who willfully allows a person to participate in the business of insurance who has been convicted of a felony involving dishonesty or a breach of trust. Consequently, anyone who willfully *allows* a person who has been convicted of a felony involving dishonesty or a breach of trust to participate in the business of insurance will be prohibited from participating in the business of insurance themselves.

The law applies to all insurance companies, regardless of the lines of business sold or the state of domicile. Persons who *"participate"* in the business of insurance include officers, directors, agents, employees, or persons authorized to act on behalf of such persons. The *"willfully permits"* language means that even if the felony was before the effective date, that person cannot be allowed to continue to participate in the business.

The Federal Crime Control Statute imposes an important prophylactic parallel to the NASD's barrier to statutorily disqualified individuals in the broker/dealer industry. This protection applies to all life and annuity sales, including variable annuities marketed to qualified plans.

Importantly, the *Sentencing Reform Act of 1984* has made a dramatic change in the federal court sentencing system since its enactment.[52] Essentially, the law provides that evidence of effective compliance programs will be regarded favorably as mitigating factors in the imposition of sentence upon a conviction for criminal behavior. The guidelines as provided

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[50]On several occasions, the DOL has publicly stated its intent to develop a standardized fee disclosure statement to facilitate comparison among competing funding arrangements for 401(k) plans. *See* Winokur, *Labor Dept. Is Developing 1-Page Fee Disclosure Form*, American Banker (Nov. 6, 1998) at 6.

[51]Ch. 47, Title 18, U.S.C. at subsection 1033 (1996).

[52]The particular provisions noted above are from the *Organizational Sentencing Guidelines*, and took effect on November 1, 1991.

in the *United States Sentencing Commission Guidelines Manual: Sentencing of Organizations*, are:

> "An effective program to prevent and detect violations of law means a program that been reasonably designed, implemented, and enforced so that it generally will be effective in preventing and detecting criminal conduct. Failure to prevent or detect the instant offense, by itself, does not mean that the program was not effective. The hallmark of an effective program to prevent and detect violations of law is that the organization exercised due diligence in seeking to prevent and detect criminal conduct by its employees and other agents. Due diligence requires at a minimum that the organization must have taken the following types of steps:
>
> (1) The organization must have established compliance standards and procedures to be followed by its employees and other agents that are reasonably capable of reducing the prospect of criminal conduct.
>
> (2) Specific individual(s) within high-level personnel of the organization must have been assigned overall responsibility to oversee compliance with such standards and procedures.
>
> (3) The organization must have used due care not to delegate substantial discretionary authority to individuals whom the organization knew, or should have known through the exercise of due diligence, had a propensity to engage in illegal activities.
>
> (4) The organization must have taken steps to communicate effectively its standards and procedures to all employees and other agents, *e.g.*, by requiring participation in training programs or by disseminating publications that explain in a practical manner what is required.
>
> (5) The organization must have taken reasonable steps to achieve compliance with its standards, *e.g.*, by utilizing monitoring and auditing systems reasonably designed to detect criminal conduct by its employees and other agents and by having in place and publicizing a reporting system whereby employees and other agents could report criminal conduct by others within the organization without fear of retribution.
>
> (6) The standards must have been consistently enforced through appropriate disciplinary mechanisms, including, as appropriate,

discipline of individuals responsible for the failure to detect an offense. Adequate discipline of individuals responsible for an offense is a necessary component of enforcement; however, the form of discipline that will be appropriate will be case specific.

(7) After an offense has been detected, the organization must have taken all reasonable steps to respond appropriately to the offense and to prevent further similar offenses -- including any necessary modifications to its program to prevent and detect violations of law."

Significantly, organizations are now strongly motivated to establish compliance standards and procedures and to monitor those procedures through a self evaluative process. Through this process, corporations can reduce exposure to liability, both criminally and civilly. Insurance and annuity consumers benefit from these initiatives.

D. Voluntary Market Conduct Effort - The Insurance Marketplace Standards Association ("IMSA")

After a comprehensive two-year period of ACLI study and development, the life insurance industry has established the Insurance Marketplace Standards Association ("IMSA"), a voluntary, membership organization for life insurance companies. IMSA provides a practical and conceptual structure to assist its member companies to maintain high standards of market conduct in the sale of individual life and annuity products. The fundamental purpose of IMSA is to facilitate, advance, and promote ethical market conduct in the life insurance industry.

An eligible life insurance company will be admitted to IMSA membership five days after filing with IMSA current reports indicating successful completion of IMSA's Assessment Questionnaire by both the eligible company and by an independent assessor approved by IMSA. An insurance company considering participation in IMSA would first need to evaluate, understand, and adopt IMSA's Principles of Ethical Market Conduct and the IMSA Code of Life Insurance Ethical Market Conduct. The company would then utilize IMSA's Assessment Questionnaire and the Assessor's Handbook to perform a market conduct self-assessment. If the company were able to respond affirmatively to each question in the Assessment Questionnaire, it would then engage an independent assessor to review the self-assessment and to perform an independent assessment following similar procedures. If the independent assessment is successful, the company would then be able to submit reports indicating such success to IMSA and could become a member. Following an advertising moratorium expiring on April 1, 1998, IMSA members were able to advertise their membership and use the IMSA logo. Membership in IMSA is good for a three-year period after which companies must undergo the assessment process anew to retain membership. As of August 4, 2000 IMSA has 240 member companies that collectively represent 82.52% of the market share for individually sold life insurance and annuity business in the United States.

The core of the IMSA market conduct initiative is the commitment of each participating life insurance company to the following Principles of Ethical Market Conduct:

"Each life insurance company subscribing to these principles commits itself in all matters affecting the sale of individually-sold life and annuity products:

1. To conduct business according to high standards of honesty and fairness and to render that service to its customers which, in the same circumstances, it would apply to or demand for itself.

2. To provide competent and customer-focused sales and services.

3. To engage in active and fair competition.

4. To provide advertising and sales materials that are clear as to purpose and honest and fair as to content.

5. To provide for fair and expeditious handling of customer complaints and disputes.

6. To maintain a system of supervision and review that is reasonably designed to achieve compliance with these Principles of Ethical Market Conduct."

The Code of Ethical Market Conduct elaborates in some detail on each of the six principles and includes commentary to clarify application and use of the Principles. The six Principles are supported implementing Code Provisions set forth in a 140-page Assessment Handbook detailing the criteria for interpreting and applying the Principles, Code, and Assessment Questionnaire.

The focus of the self-assessment done by the company and the independent assessment done by the independent assessor relates to whether or not the company has an infrastructure - policies and procedures - that will reasonably assure compliance with the Principles and Code. The program architects developed the IMSA Assessment Questionnaire to test the existence of such an infrastructure and to assist the company and the independent assessor in assessing the company's compliance with the Principles and Code. The Assessment Questionnaire consists of 24 questions. An affirmative answer is required to each of the 24 questions to enable a company to qualify for IMSA membership. There are specific questions regarding each of the Principles.

The IMSA Assessment Handbook is an instruction manual providing objective, systemic, analytical guidance to the company or its independent assessor concerning the details of assessment. In order to respond affirmatively to the 24 questions that comprise the Assessment Questionnaire, the Assessment Handbook requires an affirmative response to an extensive series of questions regarding the company's policies and procedures, the communication and use of

those policies and procedures, and the continuing monitoring by the company of the utility of the policies and procedures.

The Assessment Handbook includes a number of "indicators" to guide the assessor and to yield objective information to consider in formulating and evaluating an answer to each question in the Questionnaire. The indicators are intended to provide examples of how an insurer, regardless of size or complexity, may demonstrate compliance with the Principles and Code. In some cases an insurer may be able to identify alternative indicators not set forth in the Assessment Handbook, which will provide support for the requisite affirmative response to the questions.

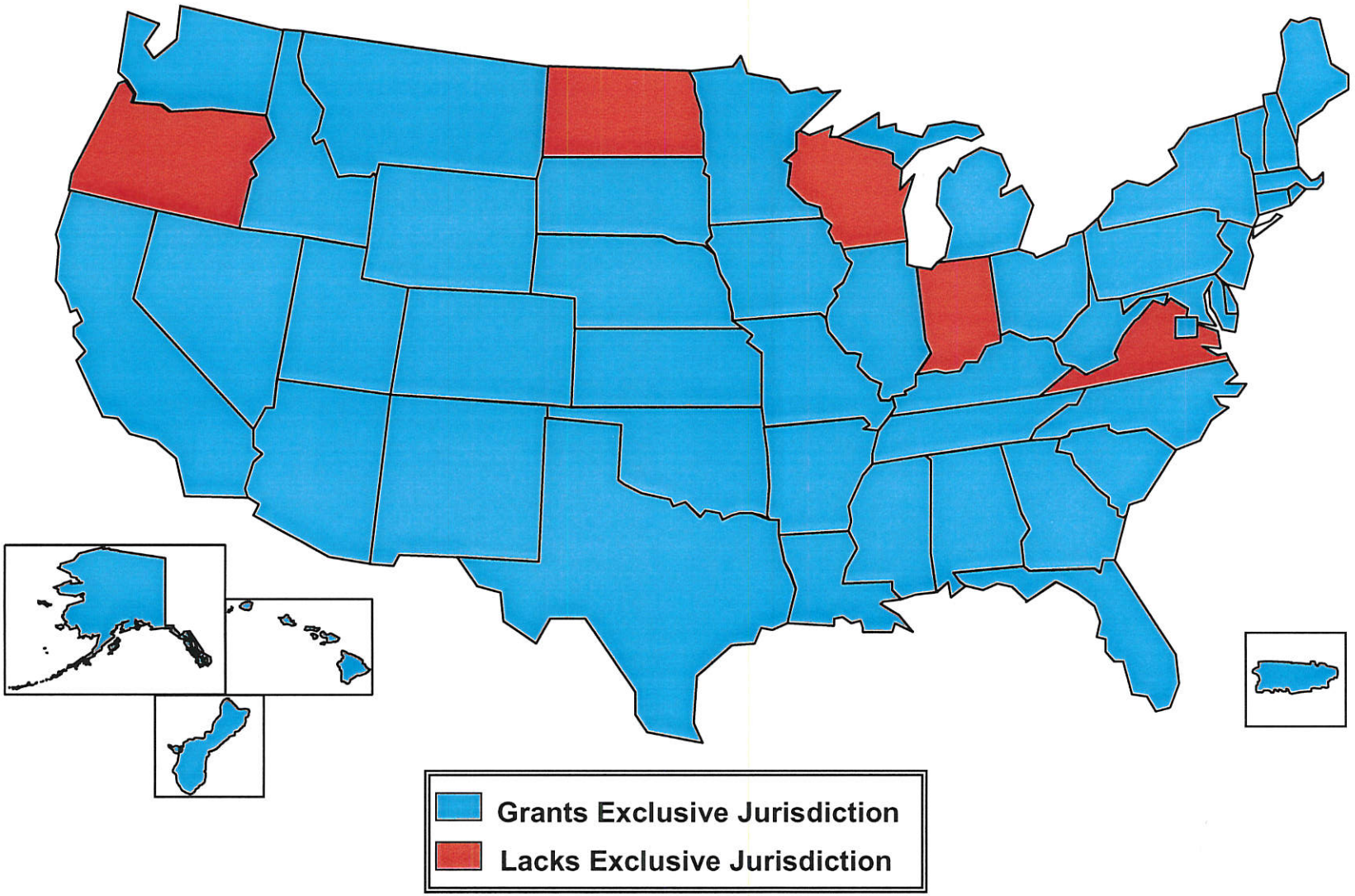
The Assessment Handbook also includes various testing procedures by which the company and the independent assessor can examine the company and its personnel in the assessment process. The Assessment Handbook also discusses permissible sampling techniques for assessors, recognizing that reviewing all documents and interviewing all employees and participants may be impractical.

Thus, while there are only six Principles that provide the foundation of the IMSA market conduct effort and only 24 questions comprise the IMSA Assessment Questionnaire, the assessment process is designed to be both comprehensive and flexible. It is designed to compel the company and the independent assessor to produce specific evidence of compliance with both the letter and the spirit of the life insurance market conduct effort.[53]

[53]IMSA's Executive Director is Brian Atcheson. An independent board of directors sets policy for IMSA.

10-36

States Granting Insurance Commissioner Exclusive Jurisdiction to Regulate Variable Contracts

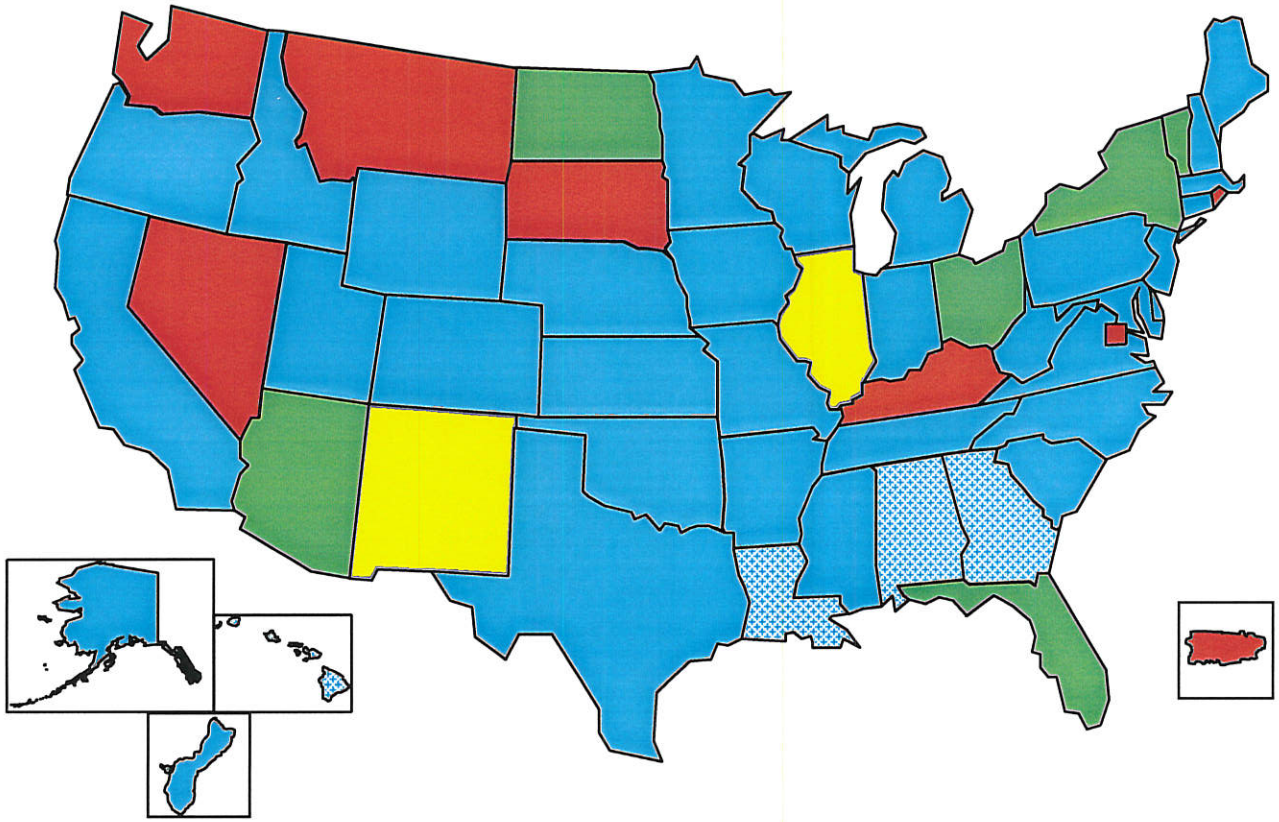


By Carl B. Wilkerson, Chief Counsel – Securities & Litigation, American Council of Life Insurers

ACLI AMERICAN COUNCIL OF LIFE INSURERS

10.37

Status of Variable Contracts Under State Securities Laws

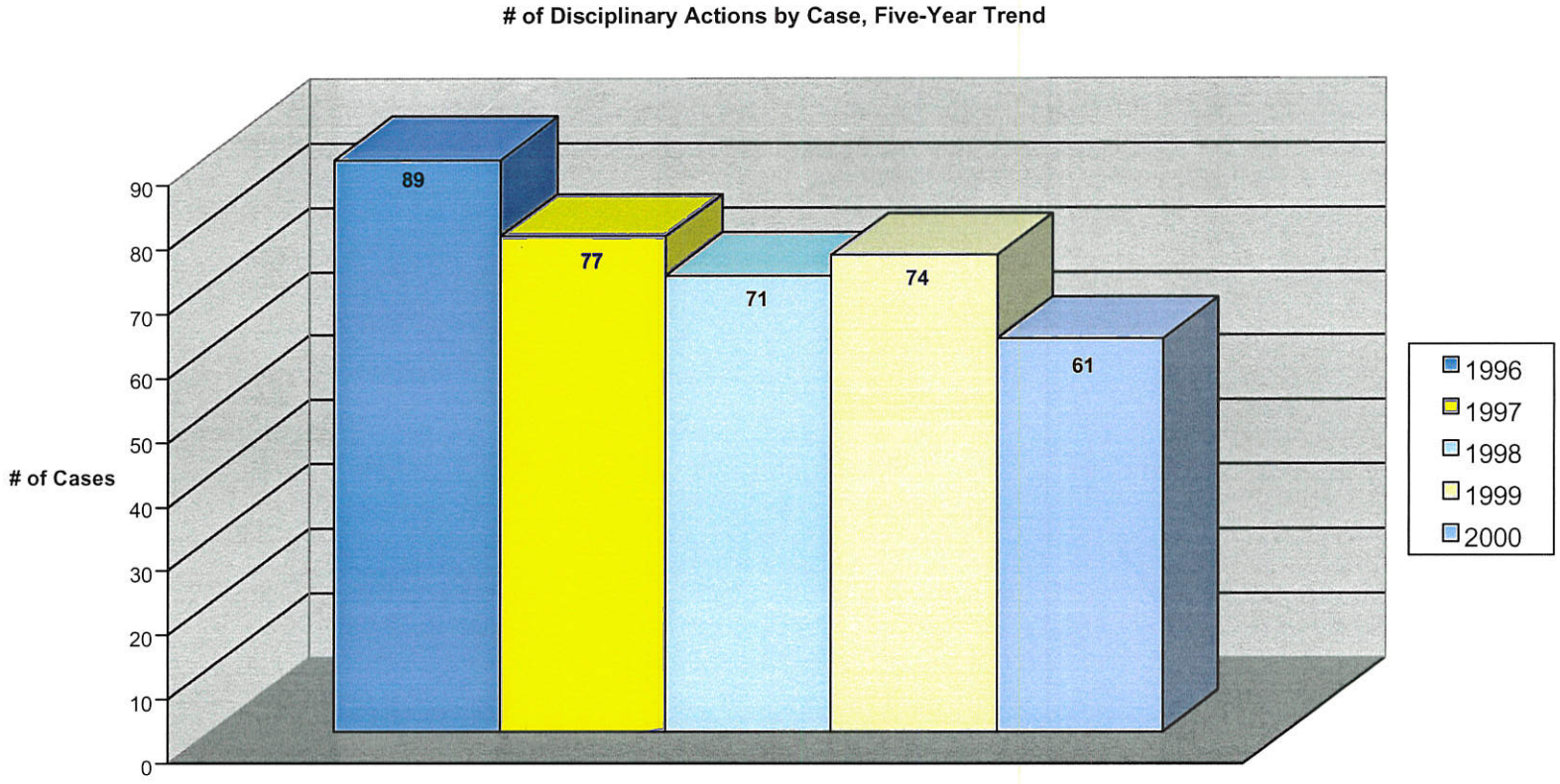


- Excludes *all* insurance, endowment, and annuity contracts from definition of security
- Excludes insurance, endowment, or annuity contracts from definition of security, but not all 3
- Defines variable annuity and variable life insurance contracts as a security
- No categories of *any* kind are excluded from the definition of security
- No exclusion from the definition of security for *any* type of insurance, endowment or annuity contract

By Carl B. Wilkerson, Chief Counsel – Securities & Litigation, American Council of Life Insurers

A·C·L·I AMERICAN COUNCIL OF LIFE INSURERS

NASD Disciplinary Actions 1996-2000:
Trends in the Distribution of Insurance and Annuities



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

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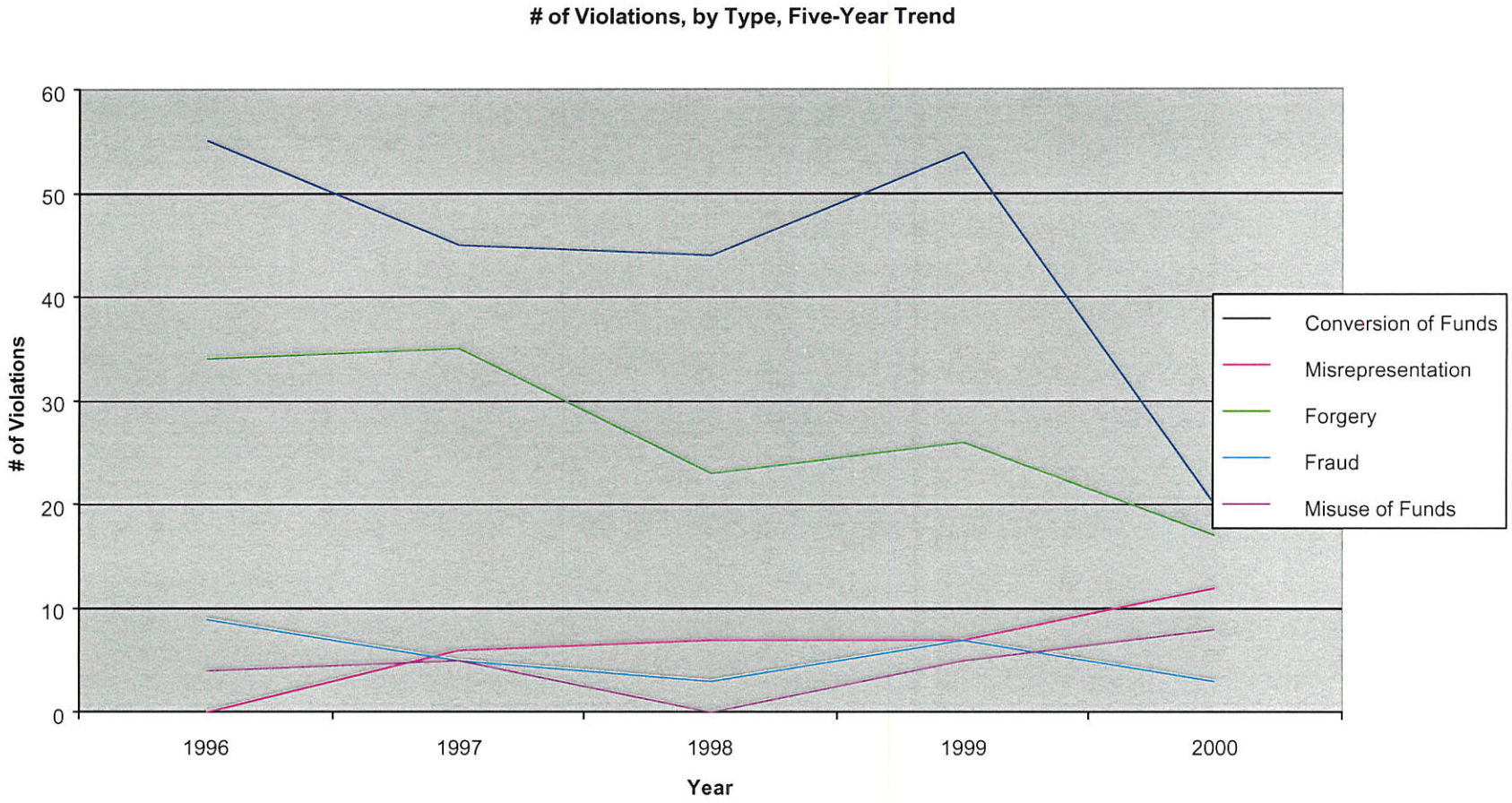

By Carl B. Wilkerson, Chief Counsel-Securities, American Council of Life Insurers

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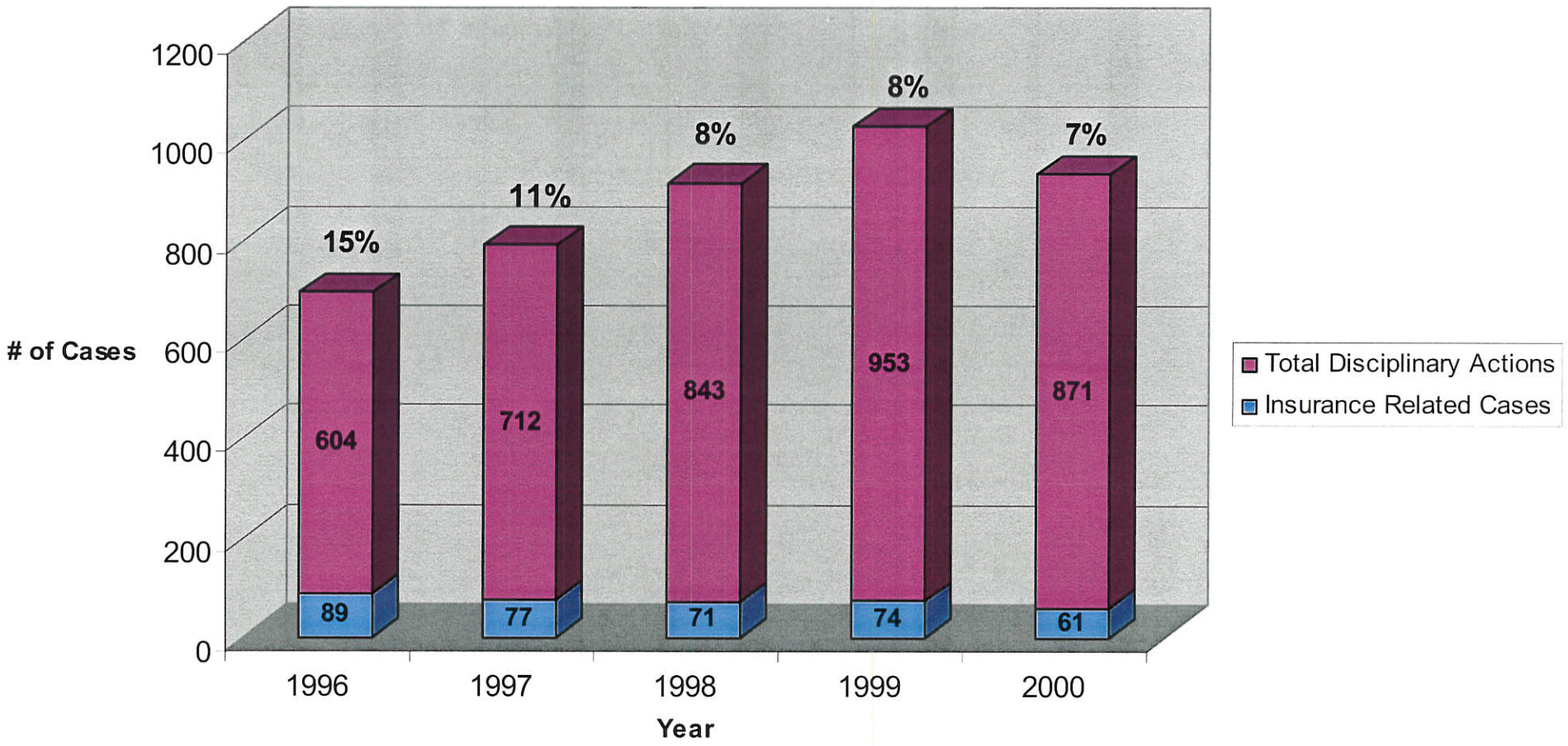

By Carl B. Wilkerson, Chief Counsel-Securities, American Council of Life Insurers

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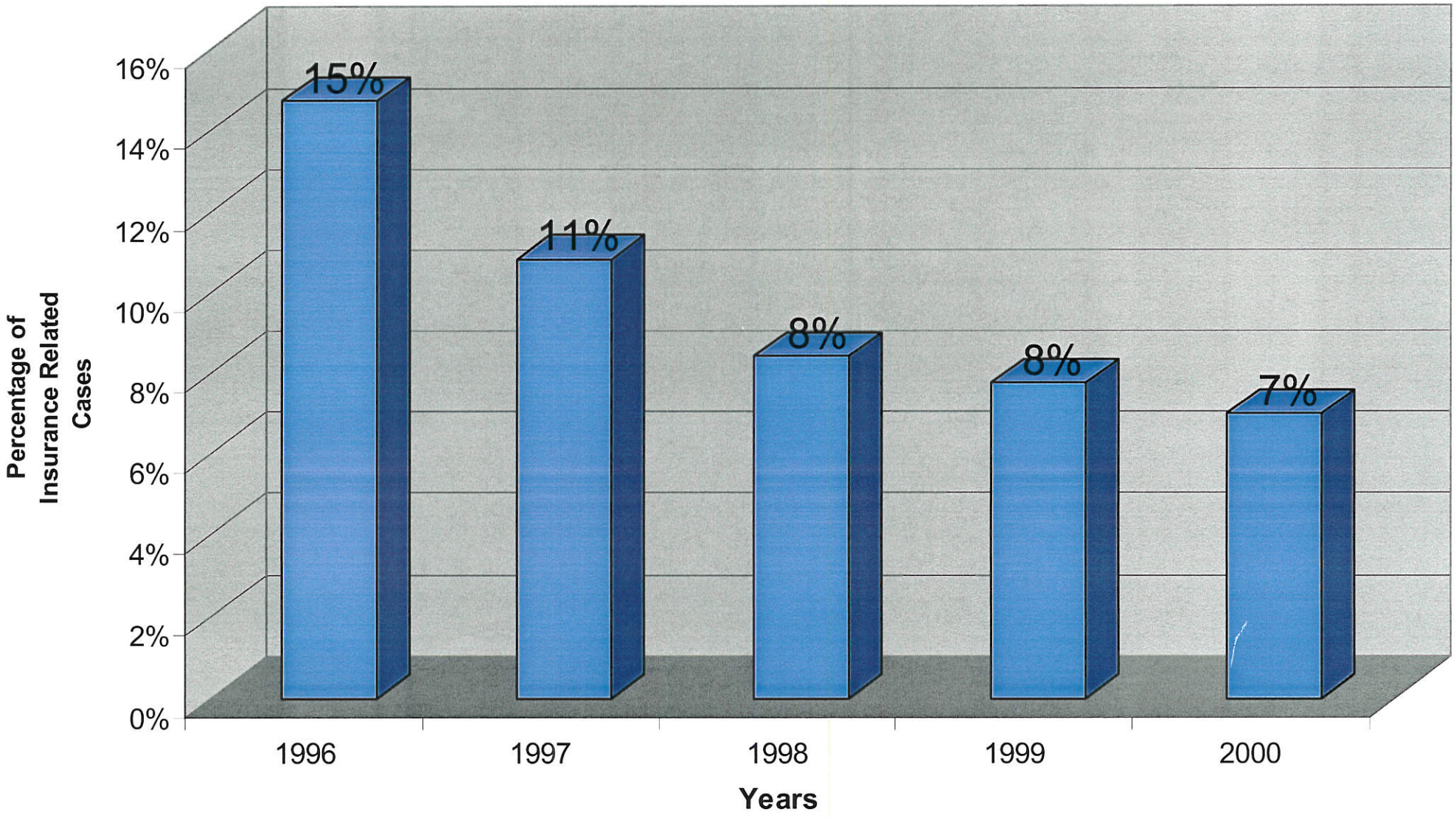

By Carl B. Wilkerson, Chief Counsel-Securities, American Council of Life Insurers

SPOTTING TRENDS:

STATISTICAL ANALYSIS OF REPORTED NASD DISCIPLINARY ACTIONS INVOLVING THE DISTRIBUTION OF ANNUITIES, INSURANCE PRODUCTS, OR BROKER-DEALERS AFFILIATED WITH LIFE INSURERS BETWEEN 1996 AND 2000.

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

I. Trend Analysis as a Barometer of Broker-Dealer Behavior

A. The NASD publishes reports of disciplinary actions monthly in its Notices to Members which highlight breaches in broker-dealer market conduct.

1. A cyclical review of the reported disciplinary actions exposes common areas of deficient conduct, while also giving early warning to evolving patterns of disciplinary misconduct that can be useful in preventive compliance programs.

2. Since 1996, I have annually compiled reviews of reported disciplinary actions involving annuities, insurance products, or broker-dealers affiliated with life insurance companies .

   a. *See*, *ALI-ABA Conference on Life Insurance Company Products: Current Securities, Tax, ERISA, and State Regulatory Issues* (2000) at 369; *See*, *ALI-ABA Conference on Life Insurance Company Products: Current Securities, Tax, ERISA, and State Regulatory Issues* (1999) at 161; *ALI-ABA Conference on Life Insurance Company Products: Current Securities, Tax, ERISA, and State Regulatory Issues* (1998) at 409; *ALI-ABA Conference on Life Insurance Company Products: Current Securities, Tax, ERISA, and State Regulatory Issues* (1997) at 597; and, *ALI-ABA Conference on Life Insurance Company Products: Current Securities, Tax, ERISA, and State Regulatory Issues* (1996) at 176.

3. These compilations provide a base of data shedding additional light on trends between 1996 and 2000, and highlight common problems and evolving patterns of behavior over a multi-year sequence.

II. What are the trends?

A. Over the period of 1996-2000, the *total number of disciplinary actions* involving annuities, insurance products, or broker-dealers affiliated with life insurance companies has progressively decreased.

B. Over the period of 1996-2000, the *number of disciplinary action by type* (conversion, forgery, misrepresentation, etc.) involving annuities, insurance products, or broker-dealers affiliated with life insurance companies has experienced a downward trend in almost every category.

C. Over the period of 1996-2000, the *total fines in disciplinary actions* involving annuities, insurance products, or broker-dealers affiliated with life insurance companies peaked in the middle of the period, and dropped off toward the end of the period. [*Note*: two cases in 1999 were not included in the fines total because the fines in the cases exceeded two standard deviations from the data set, and a fine was levied in one year for conduct spanning up to 13 years.]

D. Over the period of 1996-2000, the *average fine per disciplinary action* involving annuities, insurance products, or broker-dealers affiliated with life insurance companies peaked in 1998, and fell off thereafter. [*Note*: two cases in 1999 were not included in the calculation of average fine per disciplinary action because the fines in the cases exceeded two standard deviations from the data set, and a fine was levied in one year for conduct spanning up to 13 years.]

E. Over the period of 1996-2000, the *most frequent categories of disciplinary action* were conversion of funds (ranging from 51% to 69% of annual disciplinary actions), forgery (ranging from 7% to 20% of annual disciplinary actions), unauthorized policy loans (ranging between 3% and 25% of annual disciplinary actions), and fraud (ranging from 1% to 8% of annual disciplinary actions).

F. Over the period of 1996-2000, the *number of disciplinary actions with restitution ordered* trended downward.

G. Over the period of 1996-2000, the *average amount of restitution* peaked in 1998 and declined thereafter

H. Overall, disciplinary statistics show improved market conduct during the period.

III. What contributed to the trends?

A. It is not possible to determine with certainty the causes of the trends in disciplinary actions over this time period. There are, however, several causal factors that individually and collectively could have affected the trends depicted, including:

1. Improved market conduct by registered representatives and broker-dealers affiliated with life insurance companies;

2. More effective broker-dealer compliance programs, and allocation of increased compliance resources and staff at broker-dealers;

3. Improved understanding of regulatory and compliance responsibilities through continuing education programs that were developed and implemented in response to the Securities Industry Continuing Education Initiative over this period;

4. Increased use of deficiency reporting as a compliance monitoring tool to identify broker-dealer offices or salespersons with statistically measurable behavior outside the firm-wide norm for the broker-dealer (replacements, account turnover, etc.);

5. Prevention and avoidance of private litigation and securities arbitration;

6. Desire to retain or obtain membership in Insurance Marketplace Standards Association (IMSA);

7. Better ability to identify and weed out problem salespersons through improvements to the NASD's CRD, and more detailed factual reports about individual terminations in Form U-5.

8. SEC and NASD inspection sweeps between 1996 and 2000;

9. Responsive reaction to increased SEC and NASD enforcement actions; and,

10. Responsive reaction to increased SEC fines in prosecutions, and increased NASD fines in disciplinary actions following mandate in SEC's §21(a) Report on NASD self regulation and enforcement.

The KANSAS BANKERS ASSOCIATION
A Full Service Banking Association

February 19, 2003

To: House Committee on Judiciary

From: Kathleen Taylor Olsen, Kansas Bankers Association

Re: HB 2347: Uniform Securities Act

Mr. Chairman and Members of the Committee:

Thank you for the opportunity to submit written testimony regarding **HB 2347**, enacting the Kansas Uniform Securities Act.

Of interest to our industry is the change in the definition of "broker-dealer" that is found on Page 2 of the bill, beginning on line 4. As you can see, there is a qualified exclusion from the definition (and the securities registration requirements) for banks and savings institutions.

Current law provides a much broader exclusion, generally excluding banks, savings institutions and trust companies entirely from the term "broker-dealer". This bill excludes a bank or savings institution from the definition of broker-dealer if its activities are limited to those specified in subsections (i) and (ii). This new limited exclusion was designed to conform to activities allowed by federal law under the Gramm-Leach-Bliley Act.

While we are not objecting to this more limited exclusion, **we are here today to request an amendment to HB 2347 on behalf of the Kansas Bankers Association Trust Division**. We are requesting that the Committee amend the bill to include the words, "or trust company" on line 10 of Page Two (see attached proposed amendment).

This change would be consistent with the broker-dealer exclusion that exists under current law as I have described above. We believe trust companies are excluded from the definition under current law because many of their securities activities are already being regulated at either the federal level or the state level, just as bank securities activities are already being regulated at some level.

In conclusion, we would urge that the Committee favorably consider our request for an amendment as they consider the merits of this legislation. Thank you for your time.

H. JUDICIARY
2-19-03
Attachment: 11

610 SW Corporate View 66615 • P.O. Box 4407, Topeka, KS 66604 • (785) 2:
email kbaoffice@ink.org

Session of 2003

HOUSE BILL No. 2347

By Representative O'Neal

2-12

AN ACT enacting the Kansas uniform securities act; amending K.S.A. 12-1675, 12-1677b, 12-4516, 16-214, 17-4632, 50-1009, 50-1016, 66-1508, 74-8229 and 75-6302 and K.S.A. 2002 Supp. 17-49a01, 21-4619, 21-4704 and 75-3170a and repealing the existing sections; also repealing K.S.A. 17-1260, 17-1264, 17-1265, 17-1266, 17-1267, 17-1269, 17-1273, 17-1274 and 17-1275 and K.S.A. 2002 Supp. 17-1252, 17-1253, 17-1254, 17-1255, 17-1257, 17-1258, 17-1259, 17-1261, 17-1262, 17-1262a, 17-1263, 17-1266a, 17-1268, 17-1270, 17-1270a, 17-1270b, 17-1271 and 17-1272 .

Be it enacted by the Legislature of the State of Kansas:

New Section 1. Sections 1 through 52, and amendments thereto, may be cited as the Kansas uniform securities act.

New Sec. 2. In this act, unless the context otherwise requires:

(1) "Administrator" means the securities commissioner of Kansas, appointed as provided in K.S.A. 75-6301, and amendments thereto.

(2) "Agent" means an individual, other than a broker-dealer, who represents a broker-dealer in effecting or attempting to effect purchases or sales of securities or represents an issuer in effecting or attempting to effect purchases or sales of the issuer's securities, but a partner, officer, or director of a broker-dealer or issuer, or an individual having a similar status or performing similar functions is an agent only if the individual otherwise comes within the term. The term does not include an individual excluded by rule adopted or order issued under this act.

(3) "Bank" means:

(A) A banking institution organized under the laws of the United States;

(B) a member bank of the federal reserve system;

(C) any other banking institution, whether incorporated or not, doing business under the laws of a state or of the United States, a substantial portion of the business of which consists of receiving deposits or exercising fiduciary powers similar to those permitted to be exercised by national banks under the authority of the comptroller of the currency pursuant to section 1 of Public Law 87-722 (12 U.S.C. section 92a), and which is supervised and examined by a state or federal agency having supervision

over banks, and which is not operated for the purpose of evading this act; and

(D) a receiver, conservator, or other liquidating agent of any institution or firm included in subparagraph (A), (B), or (C).

(4) "Broker-dealer" means a person engaged in the business of effecting transactions in securities for the account of others or for the person's own account. The term does not include:

(A) An agent;

(B) an issuer;

(C) a bank, ~~or~~ savings institution if :

or trust company

(i) Its activities as a broker-dealer are limited to those specified in subsections 3(a)(4)(B)(i) through (vi) and (viii) through (x); 3(a)(4)(B)(xi) if limited to unsolicited transactions; 3(a)(5)(B); and 3(a)(5)(C) of the securities exchange act of 1934 (15 U.S.C. sections 78c(a)(4) and (5)); or

(ii) it is a bank that satisfies the conditions described in subsection 3(a)(4)(E) of the securities exchange act of 1934 (15 U.S.C. section 78c(a)(4));

(D) an international banking institution; or

(E) a person excluded by rule adopted or order issued under this act.

(5) "Depository institution" means:

(A) A bank; or

(B) a savings institution, trust company, credit union, or similar institution that is organized or chartered under the laws of a state or of the United States, authorized to receive deposits, and supervised and examined by an official or agency of a state or the United States if its deposits or share accounts are insured to the maximum amount authorized by statute by the federal deposit insurance corporation, the national credit union share insurance fund, or a successor authorized by federal law. The term does not include:

(i) An insurance company or other organization primarily engaged in the business of insurance;

(ii) a morris plan bank; or

(iii) an industrial loan company.

(6) "Federal covered investment adviser" means a person registered under the investment advisers act of 1940.

(7) "Federal covered security" means a security that is, or upon completion of a transaction will be, a covered security under section 18(b) of the securities act of 1933 (15 U.S.C. section 77r(b)) or rules or regulations adopted pursuant to that provision.

(8) "Filing" means the receipt under this act of a record by the administrator or a designee of the administrator.

(9) "Fraud," "deceit," and "defraud" are not limited to common law deceit.