***Receivers’ Handbook for Insurance Company Insolvencies***

**CHAPTER 9: LEGAL CONSIDERATIONS**

**III. Claims**

**G. Assets that are not General Assets, Special Deposits and Letters of Credit**

**4. Separate Accounts**

**CONSIDERATIONS FOR HANDLING SEPARATE ACCOUNTS**

**A. Authority**

**1. Federal Statutes and Rules**

Securities Act of 1933 ("1933 Act")

Certain annuity and life insurance contracts issued by insurers are subject to the Securities Act of 1933 and must be registered with the U.S. Securities and Exchange Commission (“SEC”), unless the contract qualifies for an exception. Consequently, an insurer issuing certain types of contracts must comply with the requirements of the 1933 Act as well as with applicable state insurance law before issuing an SEC registered contract.

Investment Company Act of 1940 ("1940 Act")

Section 2(a)(37) of the 1940 Act defines a separate account as "an account established and maintained by an insurance company pursuant to the laws of any State or territory of the United States, or of Canada or any province thereof, under which income, gains and losses, whether or not realized, from assets allocated to such account, are, in accordance with the applicable contract, credited to or charged against such account without regard to other income, gains, or losses of the insurance company."

Section 2(a)(17) of the 1940 Act defines an insurance company to include "any receiver or similar official or any liquidating agent for such a company, in his capacity as such."

Under longstanding federal court precedent and SEC regulations, an insurer’s separate account that supports a variable contract (which provides that separate account investment experience is reflected directly in contract values (“Variable Products”)) is treated as having a separate legal existence from the insurance company for purposes of the 1940 Act,[[1]](#footnote-1) and is subject to the registration and other requirements of the 1940 Act, unless an exception applies.

Securities Exchange Act of 1934 (“1934 Act”)

Sections 13 and 15(d) of the 1934 Act require insurance company issuers of certain securities registered under the 1933 Act to file regular, publicly available reports with the SEC. These reports include Form 10-K, Form 10-Q and Form 8-K. Insurers that issue annuity and life insurance contracts registered under the 1933 Act that are not supported by a separate account registered under the 1940 Act are required to file such reports, unless the insurer qualifies for an exemption. For registered Variable Products, there is an alternative and much simpler reporting requirement (a separate account annual report on Form N-SAR).

Code of Federal Regulations

Rule 12h-7 under the 1934 Act generally exempts an insurance company issuer from the duty under Section 15(d) to file reports required by Section 13(a) if: (1) the securities do not constitute an equity interest of the issuer, (2) the insurer files an annual statement of its financial condition with the insurance commissioner of the insurer’s domiciliary state, (3) the securities are not listed on any exchange, (4) the insurer takes steps reasonably designed to ensure that a trading market does not develop in the securities, and (5) the prospectus contains a statement stating that the insurer is relying on Rule 12h-7.

Rule 0-1 (e) (2) under the 1940 Act provides that, as a condition to the availability of certain exemptions, a separate account "shall be legally segregated, the assets of the separate account shall, at the time during the year that adjustments in the reserves are made, have a value at least equal to the reserves and other contract liabilities with respect to such account, and at all other times, shall have a value approximately equal to or in excess of such reserves and liabilities; and that portion of such assets having a value equal to, or approximately equal to, such reserves and contract liabilities shall not be chargeable with liabilities arising out of any other business which the insurance company may conduct."

For variable contracts funded by separate accounts that are registered under the 1940 Act, Rule 22c-1 under the 1940 Act requires insurers to calculate accumulation unit values daily and to price any premiums, withdrawals, or transfers of contract value at the accumulation unit value for such contracts that is next computed after the insurer receives the purchase, withdrawal, or transfer request in good order.

Rule 38a-1 under the 1940 Act requires insurers that sponsor a separate account registered under the 1940 Act: (i) to maintain current written compliance policies and procedures that are reasonably designed to prevent, detect and promptly correct violations of the federal securities laws (broadly defined), and (ii) to designate one individual as a chief compliance officer (“CCO”) responsible for administering the separate account’s compliance policies and procedures. An annual review must be conducted of the adequacy of the written policies and procedures and the effectiveness of their implementation, and an annual written report prepared that addresses the operation of the policies and procedures, any material changes made or recommended and each material compliance matter that has occurred since the date of the last report.

**2. State Statutes and Rules**

NAIC Model Variable Contract Law (Model Law 260)

The Model permits a life insurer to establish separate accounts for life insurance or annuities, and allocate amounts to it, provided that:

* Income, gains and losses from assets allocated to a separate account are credited to or charged against the account, without regard to other income, gains or losses of the insurer.
* Amounts allocated to a separate account are owned by the insurer, and the insurer is not a trustee with respect to such amounts. If and to the extent provided under the applicable contracts, the portion of the assets of a separate account equal to the reserves and other contract liabilities with respect to the account shall not be chargeable with liabilities arising out of any other business of the company (generally referred to as “asset insulation”).
* Transfers of assets between a separate account and other accounts are subject to restrictions. The Commissioner may approve other transfers if they are not found to be inequitable.
* Except as otherwise provided, pertinent insurance law applies to such separate accounts.

NAIC Separate Accounts Funding Guaranteed Minimum Benefits under Group Contracts Model Regulation (Model Regulation 200)

* Applies to group life insurance contracts and group annuity contracts, as described in the rule, which utilize a separate account.
* Prescribes rules for establishing and maintaining separate accounts that fund guaranteed minimum benefits under group contracts, and the reserve requirements for accounts.

NAIC Variable Annuity Model Regulation (Model Regulation 250)

* Defines a variable annuity as a policy that provides benefits that vary according to the investment experience of a separate account or accounts maintained by the insurer.
* Sets forth reserve and nonforfeiture requirements for variable annuity contracts and provides that the insurer must maintain separate account assets with a value at least equal to the reserves and other contract liabilities with respect to the account, except as may otherwise be approved by the commissioner.
* To the extent provided under the contracts, that portion of the assets of a separate account equal to the reserves and other contract liabilities with respect to the account shall not be chargeable with liabilities arising out of any other business the company may conduct.

NAIC Variable Life Insurance Model Regulation (Model Regulation 270)

* Defines a variable life insurance policy as an individual policy that provides for life insurance the amount or duration of which varies according to the investment experience of any separate account or accounts established and maintained by the insurer.
* Sets forth reserve and nonforfeiture requirements for variable life insurance policies, and provides that the insurer shall maintain in each separate account assets with a value at least equal to the greater of the valuation reserves for the variable portion of the variable life insurance policies or the benefit base for the policies.
* Provides that for incidental insurance benefits, reserve liabilities for all fixed incidental insurance benefits shall be maintained in the general account and reserve liabilities for all variable aspects of the variable incidental insurance benefits shall be maintained in a separate account, in amounts determined in accordance with the actuarial procedures appropriate to the benefit.
* Every variable life insurance policy, shall state that the assets of the separate account shall be available to cover the liabilities of the general account of the insurer only to the extent that the assets of the separate account exceed the liabilities of the separate account arising under the variable life insurance policies supported by the separate account.
* The policy shall reflect the investment experience of one or more separate accounts, and the insurer shall demonstrate that the reflection of investment experience in the variable life insurance policy is actuarially sound. The method of computation of cash values and other nonforfeiture benefits shall be in accordance with actuarial procedures that recognize the variable nature of the policy.

NAIC Modified Guaranteed Annuity Model Regulation (Model Regulation 255)

* A modified guaranteed annuity is defined as a deferred annuity, the values of which are guaranteed if held for specified periods, and the underlying assets of which are held in a separate account. The contract must contain nonforfeiture values that are based upon a market-value adjustment formula if held for periods shorter than the full specified periods of the guarantee.
* At a minimum, the separate account liability will equal the surrender value based upon the market value adjustment formula in the contract. If contract liability is greater than the market value of the assets in the separate account, a transfer of assets must be made into the separate account so that the market value of the assets at least equals that of the liabilities. Any additional reserves needed to cover future guaranteed benefits will be set up by the valuation actuary.
* Provides that the contract shall contain a provision that, to the extent set out in the contract, the portion of the assets of any separate account equal to the reserves and other contract liabilities of the account shall not be chargeable with liabilities arising out of any other business of the company.

Insurer Receivership Model Act (2005) (“IRMA”), §104 (K):

(1) "General assets" includes all property of the estate that is not:

(a) Subject to a properly perfected secured claim;

(b) Subject to a valid and existing express trust for the security or benefit of specified persons or classes of persons; or

(c) Required by the insurance laws of this state or any other state to be held for the benefit of specified persons or classes of persons.

(2) "General assets" includes all property of the estate or its proceeds in excess of the amount necessary to discharge claims described in Paragraph (1) of this subsection.

Insurers Rehabilitation and Liquidation Model Act (1999) (“IRLMA”), §3 (K):

"General assets" includes all property, real, personal, or otherwise which is not:

(1) Specifically subject to a perfected security interest as defined in the Uniform Commercial Code or its equivalent in this state;

(2) Specifically mortgaged or otherwise subject to a lien and recorded in accordance with applicable real property law;

(3) Specifically subject to a valid and existing express trust for the security or benefit of specified persons or classes of persons; or

(4) Required by the insurance laws of this state or any other state to be held for the benefit of specified persons or classes of persons.

As to an encumbered property, "general assets" includes all property or its proceeds in excess of the amount necessary to discharge, in accordance with the Act, the sum or sums secured thereby. Assets held on deposit pursuant to a state statute for the security or benefit of all policyholders or all policyholders and creditors, in more than a single state, shall be treated as general assets.

Separate Account Exclusion in Distribution Scheme

Several states have a provision in their receivership act's scheme for the distribution of assets that specifies the treatment of assets held in an insulated separate account once an order of receivership has been issued. Such state laws generally provide that, to the extent provided under the applicable contracts, the portion of the assets of any such separate account equal to the reserves and other contract liabilities regarding that account is not chargeable with any liabilities arising out of any other business of the insurance company.  *See, e.g.,* Ariz. Stat. § 20-651(D); Cal. Ins. Code § 10506(a); Conn. Gen. Stat. § 38a-433(a); N.J. Stat. § 17B:28-9(c); N.Y. Ins. Law § 4240(a)(12); Tex. Ins. Code § 1152.059.

**3. Case Law**

SEC v. Variable Annuity Life Ins. Co. of America, 359 U.S. 65(1959)

Variable annuity contracts are securities that must be registered with the SEC under the 1933 Act. Such contracts are not annuity contracts within the meaning of the exemption provided in Section 3(a)(8) of that Act for annuity and life insurance contracts, or the McCarran-Ferguson Act.

SEC v. United Benefit, 387 U.S. 202 (1967)

A deferred variable annuity that promised to return net premiums at the end of a 10-year term is a security. The Court found that, despite the guaranteed return at the end of the term, the contract owner held too much investment risk, especially when the product’s marketing appealed to purchasers with its prospect of “growth” through sound investment management rather than on “the usual insurance basis of stability and security.”

Prudential Ins. Co. v. SEC, 326 F.2d 383(3d Cir. 1964), cert. denied, 377 U.S. 953 (1964)

A separate investment account was established by Prudential for the sole benefit of variable annuity contract holders. The account was the "issuer" of securities for the purposes of the 1940 Act, and was separable from Prudential, so that the exclusion in the 1940 Act for insurance companies did not apply.

Rohm & Haas Co. v. Continental Assurance Co., 374 N.E.2d 727 (Ill. App. 1978)

A declaratory judgment determined that assets held by an insurer in insulated separate accounts equal to the reserves and other contract liabilities regarding such accounts were not subject to the claims of general creditors in the event of liquidation. The Court held that a provision in the Illinois Insurance Code stating that the insulated separate accounts may not be charged with unrelated liabilities was mandatory, and "forbids the invasion of separate accounts by a liquidator for the benefit of general creditors." The opinion did not discuss the receivership act; the case preceded the enactment of an exclusion for separate accounts in the distribution scheme.

**4. Rehabilitation Orders**

The following are examples of rehabilitation orders that provided exemptions for separate account assets:

* First Capital Life: In the rehabilitation of First Capital Life Insurance Company, the court froze policyholder withdrawals but exempted “whole or partial surrenders of variable separate account holdings of variable annuity contracts.” *See* Limited Stop Order and Notice of Hearing (May 10, 1991) at Item II.A on Page 2. *See also* Order Appointing Conservator, Establishing of Procedures and Related Orders (May 14, 1991) at Item 7 on p. 6 (“Further, whole or partial surrenders of variable separate account holdings of variable annuity contracts shall continue to be paid”).
* Monarch Life: In the rehabilitation of Monarch Life Insurance Company, the court imposed a temporary moratorium on any loan or cash surrender rights under fixed life or annuity contracts, but not under variable separate account products. *See* Verified Complaint and Request for Appointment of Temporary Receiver (May 30, 1991) at Item 24 on p. 10.
* Mutual Benefit Life: In the rehabilitation of Mutual Benefit Life Insurance Company, a court order provided that restraints on policy loans and surrenders do not prohibit the payment from separate accounts in connection with variable annuities. *See* Consent Order to Show Cause With Temporary Restraints (July 16, 1991) at Item 15 on p. 10. *See also* Order Continuing Rehabilitator’s Appointment, Continuing Restraints and Granting Other Relief (August 7, 1991) at Item 2(c) on p. 3 (extending the exemption to cover separate accounts in connection with variable life, as well as variable annuity, products).
* Confederation Life: In the rehabilitation of Confederation Life Insurance and Annuity Company, the court imposed restraints on surrenders, exchanges, transfers and withdrawals, but provided that the restraints shall not prohibit the payment of funds from separate accounts in connection with variable annuity contracts, and surrenders, exchanges, transfers and withdrawals shall be permitted without restriction and without delay. *See* Order of Rehabilitation (September 12, 1994) at Items 9-10 on p. 7-8.

**B. Considerations**

**1. Variable Products Backed by Separate Accounts Registered Under the 1940 Act:**

In the event of a liquidation of an insurance company, a separate account registered under the 1940 Act would be insulated as provided in the 1940 Act and the rules promulgated under the Act.

* The definition of "insurance company" in the 1940 Act includes a receiver, or a similar official or liquidating agent for such a company.
* A separate account is treated as an investment company separate from the insurance company for purposes of the 1940 Act.
* In *SEC v. Variable Annuity Life Insurance Co. of America*, the 1940 Act was not reverse pre-empted by the McCarran-Ferguson Act.

**2. Products (Variable or Fixed) Backed by Separate Accounts NOT Registered under the 1940 Act:**

If a separate account has been used by an insurer to back certain kinds of benefits guaranteed by the insurer under certain annuity contracts or life policies, the 1940 Act may not always apply to that separate account. However,

(a) A separate account not governed by the 1940 Act may nevertheless be treated as legally insulated under a state's receivership act:

* If the state variable contract law (and the policy/contract, if necessary) so provide.
* If a state insurance law requires that a separate account be held for the benefit of specified persons, it is not a general asset under an act based on IRMA or IRLMA.
* If the separate account is established as a "valid and existing" express trust for the security or benefit of specified persons as described in the receivership act, it is excluded from the general assets of the receivership under an act based on IRMA or IRLMA.
* If the receivership act's distribution scheme contains a provision that governs the treatment of a separate account, and the account is established as specified by such provision, then claims under the separate account agreement are payable from the account as provided by the provision.

# (b) If accounts are established in accordance with any of the requirements described in (a), they should be reflected as restricted assets on the receivership’s financial statement. (It should be noted that state statutes or rules may vary from the NAIC models. Not all states have a specific exemption for separate accounts in the distribution scheme, and differences also exist in variable contract laws. At least one state has prohibited the use of insulated separate accounts for non-variable products that do not reflect investment results of the separate account, but have guaranteed rates or returns. *See* Minnesota Department of Commerce Bulletin 97-6, October 22, 1997.)

# (c) If an account is not exempted from the definition of a general asset or excluded from the distribution scheme, the receivership act will typically provide that it is subject to distribution to creditors.

# (d) An annuity contract or life policy that imposes certain significant investment risks on the owners, such as a “market value adjustment,” or an “index-linked variable annuity,” might be required to be registered under the 1933 Act regardless of whether it is funded by a separate account registered under the 1940 Act (“Other SEC Registered Products”):

* Other SEC Registered Products such as registered modified guaranteed annuities and index-linked variable annuities may be funded by a separate account established in accordance with one of the requirements described in B.2.(a), above.
* Whether or not funded by a separate account, the receiver could face compliance issues under the 1933 Act with respect to such Other SEC Registered Products.
* Section 989J of the Dodd-Frank Act[[2]](#footnote-2) contains a provision that limits the ability of the SEC to classify indexed annuities and other insurance products as securities. This provision known as the Harkin Amendment.

# (e) Transfers between a separate account and other accounts may create issues in a receivership. Under the NAIC Model Variable Contract Law, such transfers are subject to restrictions, and the Commissioner may approve transfers that are not "inequitable". Because the Model Law states that pertinent provisions of insurance law apply to separate accounts, except as otherwise provided, the provisions of a receivership act regarding voidable transfers and preferences may be applicable to such transfers.

**C. Guidelines**

The following identifies the issues, documents and material a receiver should focus on immediately if faced with a troubled insurance company ("TIC") that issued Variable Products or SEC Registered Products. In addition, a receiver should collaborate with guaranty associations (through NOLHGA in multi-state insolvency) and ensure that they are involved as soon as practical regarding registered products that may be eligible for guaranty association coverage, especially with respect to compliance, operational, and other issues arising from the possible continuation of coverage of such products.

# **Determine the Type(s) of Separate Accounts that Support the Products TIC Issued and Obtain Registration Statements for the SEC Registered Products**

## Variable Products Backed by Separate Accounts Registered Under the 1940 Act. There are two types of 1940 Act Separate Accounts that TIC would have been required to register with the SEC. The applicable federal securities laws compliance issues that the receiver/insurance regulator of TIC will face differ somewhat depending on the type of Separate Account:

### Unit Investment Trust Separate Account ("UIT"). Most variable products offered today utilize Separate Accounts that fall into this category. It is characterized by a "passive" Separate Account[[3]](#footnote-3) into which premiums are deposited and allocated to "subaccounts," each of which invests in a specified underlying mutual fund, which itself must be registered under the 1940 Act. The underlying mutual fund may or may not be managed by an affiliate of TIC.

### Managed Separate Account. A Separate Account that invests directly in a portfolios of securities or other investments and, therefore, actively manages the investments at the Separate Account level, and has a board of directors responsible for managing the Separate Account. *See* Section C (5)(D), below.

## Variable Products Backed by Separate Accounts NOT Registered Under the 1940 Act ("Exempt SAs").

### Separate Accounts supporting Variable Products issued in connection with certain qualified retirement plans as specified in Section 3(a)(2) of the 1933 Act and Section 3(c)(11) of the 1940 Act. Such Separate Accounts are not registered under the 1940 Act and the Variable Products are not registered under the 1933 Act.

### Separate Accounts supporting private placement (i.e., not registered) Variable Products under Section 4 of the 1933 Act and either Section 3(c)(1) or Section 3(c)(7) of the 1940 Act. Very limited in number and qualification of policyholders. Such Separate Accounts are not registered under the 1940 Act.

### Even though these insurance products are exempted from SEC registration, they are still deemed to be securities,  and are subject to the anti-fraud provisions of the federal securities laws.   The offering documents (e.g., private placement memorandums, including financial statements) and marketing materials for these products must not contain any material omissions or misstatements. Once a TIC goes into receivership, the offering documents and marketing materials for such products should be amended to reflect such a material event and to explain the consequences for the contract owner.

## Other SEC Registered Products Backed by Separate Accounts NOT Registered under the 1940 Act. In certain situations, products other than Variable Products may be registered under the 1933 Act and may be backed by a separate account that is not registered under the 1940 Act. (see Section B. 2 above).

## Obtain and Review Available 1933 Act and 1940 Act Reports and Registration Statements. Both UITs and Managed Separate Accounts must file annual reports under the 1940 Act with the SEC on Form N-SAR. Managed Separate Accounts must file additional semi-annual reports with the SEC and send semi-annual reports to shareholders. The issuers of all SEC registered products must file updated registration statements with the SEC each year that contain current audited financial statements for the insurance company (and for the separate account, if the separate account is registered under the 1940 Act),[[4]](#footnote-4) except in limited circumstances. [[5]](#footnote-5) For products registered under the 1933 Act that are not backed by 1940 Act registered separate accounts, there could be filings that must be made with the SEC under Section 15(d) of the 1934 Act (Forms 10-Ks, 10-Qs and 8-Ks). The regulator/receiver should obtain a complete set of all SEC filings, including:

### All recent SEC registration statements containing audited financial statements

### All periodic reports

### TIC’s “plan of operations” or similar documentation for the operation of the Separate Account(s) (filed with certain state insurance departments)

### All agreements with reinsurers, distributors, third party credit support providers, guarantors, investment advisors to the underlying mutual funds, custodians and other service providers involved in TIC's maintenance of the Separate Account(s)

## Rule 38a-1 Written Compliance Policies and Procedures and Annual Reports of the Chief Compliance Officer. Rule 38a-1 under the 1940 Act provides that all separate accounts registered under the 1940 Act must have written compliance policies and procedures that are reasonably designed to prevent violations of the federal securities laws. In addition, Rule 38a-1 requires that the insurer appoint a Chief Compliance Officer (“CCO”) for each separate account registered under the 1940 Act, and that an annual review and annual report must be prepared each year documenting the effectiveness of the company’s compliance policies and procedures. The receiver should obtain a complete set of the registered separate account’s Rule 38a-1 written compliance policies and procedures and the written annual reports previously prepared, and consider how compliance with Rule 38a-1 will be accomplished during the period of the receivership.

# **Determine the Type(s) of Products TIC Issued and TIC's Net Financial Exposure**

## Locate and review all Prospectuses TIC filed with the SEC, and all Product Forms TIC Issued. Unless TIC utilized only Exempt SAs, Variable and Other SEC Registered Products would require TIC to file a Prospectus and updated audited financial statements with the SEC under the 1933 Act for each Variable and Other SEC Registered Product and keep the Prospectus and financial statements current for as long as TIC was issuing such Products.

### Section 10(a)(3) of the 1933 Act requires that SEC Registered Product issuers (and underlying funds) making a continuous offering of their securities maintain a current or “evergreen” prospectus. The receiver should obtain and review ALL Prospectuses and ALL Variable Product and SEC Registered Product forms issued by TIC (which Product Forms should have been filed and approved for issuance by TIC's insurance regulators).

### The SEC believes that issuers of variable annuities that contemplate a series of purchase payments are under a duty to maintain a current prospectus as long as payments may be accepted from contract owners. The SEC views each premium payment under a Variable Product as the purchase of a new security. Absent TIC suspending the ability of policyholders to make additional premium payments on Variable Products and SEC Registered Products, TIC should continue to update its Registration Statements and Prospectuses, unless no-action relief from SEC staff has been obtained. [[6]](#footnote-6)

## Determine all Guaranteed Benefits issued by TIC. Guaranteed Benefits (on both Variable and fixed products) will include expense charge guarantees and mortality guarantees, but likely will also include some combination of “optional” guaranteed benefits:

### Guaranteed Living Benefits ("GLBs"), which may take various forms, including one or more of the following:

#### Guaranteed Minimum Withdrawal Benefits ("GMWBs"), including Guaranteed Lifetime Withdrawal Benefits (“GLWBs”)

#### Guaranteed Minimum Accumulation Benefits ("GMABs")

#### Guaranteed Minimum Income Benefits ("GMIBs")

### Guaranteed Death Benefits ("GDBs")

## Determine standards governing the Guaranteed Benefits. Guaranteed Benefits may be based upon, or determined from, one or more of the following:

### Guaranteed return of premium

### Guaranteed annual interest rate return (roll-up)

### Highest anniversary (or other periodic) value (step-up)

### Other

## Determine TIC's financial risk not supported by a Separate Account. Review all actuarial memoranda and analysis to determine:

### Amount of premium allocated to fixed investment options provided by TIC under variable and fixed products, which may be:

#### Fixed products or investment options funded by a separate account, or

#### Funds held by TIC in its general account subject to TIC's commitment to provide minimum guaranteed interest returns.

### Amount of TIC's exposure on Guaranteed Benefits not fully funded by separate account

### TIC's exposure to increased risk by policyholder behavior (e.g., partial withdrawals and surrenders under dollar-for-dollar guarantees or proportional guarantees, or movement of money within separate account or between separate account and fixed account options).

### Surrender Charges remaining on Variable Products

## Determine TIC's financial hedging transactions to support its Guaranteed Benefits and other obligations under its Variable and SEC Registered Products.

# **Evaluate Options**

## Are TIC’s hedging programs adequate?

### Are the terms of the hedging programs adequate to protect TIC from further financial loss if economy deteriorates?

### Are TIC’s hedging program partners willing and financially able to satisfy their obligations under the hedging program agreements?

### Is there any ability or opportunity to transfer, or to obtain hedging partner consent to transfer, the hedging program to a solvent assuming insurer that might be willing to assumptively reinsure the Variable Products and other SEC Registered Products and take over the Separate Accounts?

## What administrative systems are in place to match daily the value of the Separate Account to each Variable Product?

### Are the systems adequate and working properly?

### Who owns the systems? Does TIC own the systems, or does it license the systems or contract with a third party vendor to provide the systems?

## What regulatory or receiver actions might require disclosure to owners of Variable and other SEC Registered Products and/or the SEC under 1933 Act or 1940 Act?

### The initiation of a receivership would likely, in and of itself, require filings with SEC and disclosures to owners of Variable and other SEC Registered Products.

### Any efforts to “sell” the Variable and other SEC Registered Products to another carrier could involve, at a minimum, obtaining a “no action” letter from SEC staff that addresses registration requirements.

## What, if any, restrictions on contract rights under Variable and Other SEC Registered Products might be imposed by a receivership court to the extent it is determined advisable?

### Unless supported by Exempt SAs, Variable Products (or the unitized interest in the Separate Account) constitute “redeemable securities” under the 1940 Act. Section 22(e) of the 1940 Act provides that the issuer of a redeemable security registered under the 1940 Act may not suspend the right of redemption and must pay redemption proceeds within seven days. There is no clear legal guidance about whether a court with jurisdiction of TIC (i.e., the insurance company issuer of Variable Products) could order any temporary or partial restrictions (e.g., a temporary moratorium, or a temporary limitation on partial withdrawals or surrenders). A receiver should contact the SEC staff prior to seeking any order from the receivership court restricting withdrawals funded from a 1940 Act registered separate account. This includes partial withdrawals, full surrenders, death benefits, 1035 exchanges and similar transactions.

### Suspending acceptance of premiums under Variable and other SEC Registered Products raises disclosure issues under the federal securities laws, that is whether the insurer had adequately disclosed previously to those considering purchasing the contract that it had reserved the right to take that action in the future.

## Cash Out Offer with Waiver of Remaining Surrender Charges?

### In cases where the economic value to TIC of remaining surrender charges plus ongoing fees on Variable Products are less than the economic burden of TIC’s guarantees, offering incentives to owners of Variable Products to surrender by offering a “free” full surrender window should be considered.

### Such offers should not create any preferences since Separate Account assets can be used only to support obligations under Variable Products. So, other policyholders should not be harmed, unless there could be an exposure to an anti-selection problem created by incentive.

### Should explore possible 1035 exchange options with other insurers to minimize possible adverse tax impact on owners.

### Any cash out offers involving Variable Products or SEC Registered Products likely would create disclosure obligations under the 1933 Act, and depending on the facts and circumstances for Variable Products, the possible need for no-action or exemptive relief under the 1940 Act.

## What Guaranty Association coverage for the Variable Products might be available?

### GAs exclude from coverage any investment risk or other risks borne by the Variable Product owners and/or not guaranteed by an insurer. Nonetheless, as either life insurance or annuities, Variable Products may be eligible for coverage by GAs subject to this nearly uniform exclusion. The regulator or receiver should work with the National Organization of Life and Health Insurance Guaranty Associations (“NOLHGA”), which will coordinate with its member guaranty associations (“GAs”) to evaluate coverage and the possible methods by which the GAs may discharge their statutory obligations. Early communications with the GAs through NOLHGA to help evaluate the possible GA coverage and approaches for delivering that coverage, including with respect to compliance, operational, and other issues arising from the possible continuation of coverage of such products, would be an important piece of the approach.

## Are TIC’s Separate Accounts UITs or Managed Separate Accounts or Exempt SAs? If TIC structured its separate accounts as Managed Separate Accounts (i.e., actively managed and investing directly in securities), then it will be governed by a separate board of directors (sometimes called a board of managers) subject to specified duties and obligations under the 1940 Act.

### What, if any, authority does TIC have over the Separate Account Directors or their election or appointment?

### What limitations exist on the actions of those in control of the Separate Account?

# **Coordination with Other Interested Federal Regulators**

Other regulators may be involved with issues concerning the insulation of separate account assets, such as federal banking regulators concerning variable contract *bank owned life insurance* (BOLI) funded through the life insurer’s separate accounts.  Receivers should identify other interested federal regulators and establish lines of communication with them.

# **General Guidance for Receivers in a Future Receivership of a Troubled Insurer that Issued SEC Registered Products**

Through discussions with SEC representatives about the national state-based system of insurance financial regulation and its insurance receivership process, the life guaranty system, and issues an insurance receiver might encounter in a rehabilitation or liquidation of a troubled insurer that issued SEC registered products (the insurer), general guidance for receivers was developed.  The following guidance covers the SEC’s role and identifies areas where receivers should be in communications with the SEC staff, and the receiver’s own experienced legal counsel, about registered products and how the receiver might handle the products in the receivership.

1. **SEC Staff Contacts**

As part of the guidance, organizational points of contact at the SEC were established. Receivers will need to know how to reach the appropriate staff contacts at the SEC when involved in a receivership with insurance products registered as securities. The SEC’s website contains contact numbers for SEC offices in Washington and for SEC’s regional offices: [www.sec.gov](http://www.sec.gov).

The Division of Investment Management regulates investment companies, variable insurance products, and federally registered investment advisers. Types of investment companies include mutual funds, closed-end funds, unit investment trusts, and exchange-traded funds. Information regarding the Division of Investment Management and how to contact them may be located on the SEC’s website, at [http://www.sec.gov/investment](http://www.sec.gov/investment#.Ux2x9cLD9dh).

1. **SEC’s Role**

Investor protection is central to the federal securities laws and the rules applicable to securities products, which includes insurance products that have been registered with the SEC as securities.  A receiver benefits from understanding the SEC’s possible role if the insurer enters receivership with registered insurance products in its product portfolio.  The SEC is not a solvency regulator for insurance companies and, of course, is not a receiver.   While the state insurance receivership laws of the state where the insurer is domiciled primarily govern the receiver’s duties and obligations, any federal securities laws applicable because of the insurer’s registered products would impact the receiver.  The federal securities laws may require receivers to do certain things in terms of disclosure and compliance with federal securities laws, which may vary depending on the insurance product that is registered.

In addition to insurance products that are registered as securities, there are certain types of insurance products that are securities but are exempt and therefore not registered with the SEC.

1. **Insurer Receivership**

In any receivership, it is important for the receiver to understand the nature of the insurer’s business and how the insurer’s products are administered. The receivership will be very fact specific and circumstance driven, given the particular contracts, the market at the time and the insurer’s assets. What securities laws that might apply are based on the products the insurer issued (e.g., variable, fixed, indexed, etc.).

The receiver’s team should include legal counsel qualified to provide advice on the federal securities laws the rules under those laws and compliance issues, and on how state receivership laws and federal securities laws might interact in a receivership. The receiver needs to ensure that communication channels are open with the SEC staff and needs to ensure that the requirements imposed by the federal securities laws and the rules under those laws are met. The receiver will communicate with the SEC staff during receivership. During rehabilitation and liquidation, the receiver stands in the shoes of the insurer and thus may have responsibility to comply with the federal securities laws applicable to the insurer and its separate accounts. In connection with the liquidation of the insurer, the extent of the guaranty associations’ role and responsibilities would need to be analyzed based upon guaranty association triggering and the structure used by the guaranty associations in meeting their statutory obligations. As a practical matter, the structure could be that the guaranty association assumes or guarantees the contracts or transfers the contracts to another commercial insurer or a special purpose vehicle (“SPV”).

1. **Federal Securities Laws and Considerations Overview**

The rules under the federal securities laws require that audited GAAP financial statements for the separate account (GAAP-basis) and the insurance company (GAAP, or SAP, if permitted) be included in registration statements that are filed with the SEC.[[7]](#footnote-7) There are also periodic reporting obligations under the 1934 Act that have to be complied with as well. The federal securities laws and the rules under those laws regulate registered Variable Products by requiring insurance companies to conduct operations in a certain way. The 1933 and 1934 Acts impose disclosure obligations with regard to registered Variable Products and the 1940 Act imposes disclosure and operating requirements on the registered separate accounts that issue those products. The Variable Products that must be registered with the SEC under both the 1933 Act and the 1940 Act are variable annuity (“VA”) contracts and variable life insurance (“VLI”) policies (unless there is an applicable exemption). These products must be registered because they are securities and the policy owner receives a pass through of the investment performance of the assets that are held in the separate accounts. The 1933 Act is a disclosure regime that requires a prospectus to be included as a part of the registration statement. The 1940 Act classifies separate accounts that insurance companies create to fund variable products as investment companies and generally requires that they be registered. A separate account is essentially a pool of assets under the control of the insurance company but where policy owners have a beneficial interest in the assets in that pool and in the financial performance of those assets. For that reason, the 1940 Act and the rules under that Act place stringent regulatory requirements on separate accounts. These requirements are similar to the requirements for mutual funds.

There are two types of insulated separate accounts that are used to fund VA and VLI products: 1) the managed separate account, and 2) the unit investment trust. Under a managed separate account, the separate account must have an investment advisor and a board of directors. See Section C (1), above. Under a unit investment trust, the insurer acts as a depositor, and the separate account has no board of directors. The managed separate account was the original VA and VLI funding vehicle; however, registered managed separate accounts are currently out of practice and rare.

In order to sell registered VA and VLI products, the insurer must file a registration statement under both the 1933 Act and the 1940 Act with the SEC. This registration statement includes a prospectus, statement of additional information, audited financial statements for the separate account and the insurer, and other exhibits. Top executives and directors of the depositor insurance company must sign it. The executives and directors who are required to sign the registration statement can be held personally liable for material misstatements or omissions in the registration statement. The statement must be refiled with the SEC at least annually to update the financial statements and any other changes in disclosure. A receiver of the issuer in a receivership would become liable for material misstatements or omissions in the registration statement. In a provision of a federal law passed in 1996, states are prohibited from requiring more or different disclosures in the prospectus for registered products than are required under the federal securities laws. The intent was to have uniform disclosure for nationally offered products.

Under the 1940 Act, Variable Products funded by a unit investment trust type of separate account are two-tiered products. The assets of a unit investment trust are unitized, are invested in shares of the underlying insurance-dedicated mutual funds offered in the prospectus for the variable product, and must be valued daily. The separate account is the top-tier investment company and the mutual funds are the bottom-tier investment company. Rule 22c-1 under the 1940 Act requires that daily valuation of the separate account units be done using forward pricing, meaning that the units of the separate account will not be priced until the close of business on the day when a contract owner makes a premium payment or requests a transaction involving separate account assets, or separate account assets are otherwise involved in a permitted transaction. A mortality and expense risk charge is deducted from the daily unit value of the separate account assets. Similar to the daily valuation of units, the 1940 Act has a daily redeemability requirement, which requires that units of the separate account must be redeemed at their value computed at the close of business on the day during which the units are tendered for redemption. Payout must occur within seven days. There is also a requirement for the daily pass-through of the investment performance of the underlying funds in which separate account invests such that each contract owner has a right to their proportional share of the monetized value of the separate account assets. A chief compliance officer must be appointed to ensure adherence to written compliance policies and procedures and to conduct an annual review of these policies and procedures. The SEC has multiple enforcement powers available to it, and a receiver of the issuer in a receivership is included within the purview of the 1940 Act. The separate account assets are recorded in book-entry form and there is no physical separation of assets.

There are other types of registered insurance products, such as: certain fixed annuities (and, potentially, life products) with market value adjustments (“MVAs”) and certain index-linked variable annuities (“ILVAs”) that must be registered under the 1933 Act. 1933 Act registration means that the insurance company must file a registration statement with the SEC to register the insurance product; the registration statement includes a prospectus that contains extensive disclosures and the signatures of the executives and directors of the insurance company, subjecting them to anti-fraud liability. The registration statement must contain the audited financial statements for the insurance company (as well as any third party guarantor or credit support provider) and be updated regularly. Registered MVAs, indexed life and annuities products and ILVAs may or may not be funded through a separate account; for these types of products there is no requirement that any separate account be insulated. In order for the separate account not to be registered under the 1940 Act, the separate account’s investment experience cannot pass directly through to the contract owners. The separate account’s insulation alone does not trigger 1940 Act registration. It is also possible to have aspects of both registered fixed and variable annuities in a single product.[[8]](#footnote-8)

Securities that are exempted from the 1933 and 1940 Acts include certain Variable Products sold in the pension market (qualified products) and certain Corporate Owned Life Insurance (“COLI”) and Bank Owned Life Insurance (“BOLI”) products that otherwise might be deemed to be securities. Private placement VA and VLI products are also exempted, as it is assumed that the owners are highly sophisticated or have the financial wherewithal to sustain losses and retain consultants and/or representatives to help assure that they fully understand the investments. In addition, there is an exclusion in Section 3(a) (8) of the 1933 Act for traditional insurance products under which contract owners do not bear significant investment risk and which are not regarded as securities. It is possible to have combined contracts, which includes annuity or life insurance products that are partially registered and partially excluded.

In regard to receiverships, the federal securities laws provide the SEC staff with several legal tools to protect the insulation of separate accounts. In a receivership situation, a receiver has a responsibility to comply with the requirements of the 1940 Act and 1933 Act. Under the 1940 Act, the receiver should preserve separate account insulation. A receiver should contact the SEC staff prior to seeking any order from the receivership court restricting withdrawals funded from a 1940 Act registered separate account. See Section C (3). If the product is SEC registered, the receiver generally must maintain the registration statement. The receiver generally must update and send prospectuses to investors at least annually,[[9]](#footnote-9) and file updated registration statements meeting the requirements of the 1933 Act, which would include updated audited financial statements (including the consent of the auditing firm), and updated disclosures about a receivership and any contract changes.

An SEC order would be required to de-register a separate account. There can be a provision in the contracts, which reserves the right for the insurer to deregister a separate account, but there is usually nothing beyond that.

1. **Rehabilitation**

In rehabilitation, the receiver attempts to stabilize and improve the insurer’s financial status while the insurer continues to operate. The receiver manages all aspects of insurer’s operations and takes action necessary to remedy insurer’s financial problems, to protect its assets and to run off its liabilities to avoid liquidation, while protecting its policyholders. Rehabilitation may be used to implement (1) sale of the insurer, (2) runoff of claims, including a reduction in benefits due, including ratable payments on claims as they come due[[10]](#footnote-10), and/or (3) a transition to liquidation.

Upon assuming the insurer’s management, the receiver will:

* Identify the types of insurance products to be administered during rehabilitation
* Determine whether or not the products are registered with SEC
  + Variable Products and Other SEC Registered Products: Receivers need to be aware that there may be products other than Variable Products registered with the SEC on the insurer’s books. These other products may present different federal securities law compliance issues and different communications with the SEC
* Determine types of separate accounts supporting the products
* Obtain copies of all reports filed with the SEC for the separate account and/or insurance products
* Obtain registration statements and prospectuses, and all current agreements with reinsurers, distributors, credit support providers, guarantors, custodians and other service providers, and investment advisors/managers, that are listed as exhibits in the registration statements
* Obtain Rule 38a-1 compliance policies and procedures and annual compliance reports for registered separate accounts
* Obtain copies of any significant SEC orders or other relief applicable to the separate account that modifies the regulatory regime governing the account
* Determine all guarantees provided with the products, and the standards governing those guarantees
* Determine amount of the insurer’s financial exposure not supported by separate accounts
* Determine what laws (state, federal, securities) apply to the SEC registered products and separate accounts, and evaluate options for proceeding in the rehabilitation
* Review and evaluate the impact of and compliance with the applicable state receivership laws and federal securities laws applicable to the insurer and its registered products and any separate accounts, and evaluate options for proceeding in the rehabilitation

Once the insurer enters rehabilitation, from an operations standpoint, the receiver should consider maintaining the insurer’s infrastructure, compliance program, technology, fund managers, etc., unless there are credibility issues with them. Keeping the existing infrastructure, provided there are no inherent problems in it, is the least disruptive for the policyholders and should assist the receiver with complying with the requirements of the federal securities laws. The receiver will also need to make sure to retain the right people to manage the separate account assets and the SEC filings.

Receivership statutes permit use of a rehabilitation plan excusing certain of the insurer’s obligations in order to address causes of the insurer’s financial difficulties, but only under certain circumstances consistent with the primary goal of protecting policyholder interests.

* The insurer continues to operate and to pay claims in the ordinary course of business, subject to the possible imposition of a moratorium on policy surrenders and withdrawals and in rare cases on benefit payments (subject to any requirements applicable under the federal securities laws).
* The insurer’s contract obligations and assets, and the market at the time, will all bear upon the viability of a rehabilitation plan.

It is envisioned that some of the actions a receiver might take in aid of insurer’s rehabilitation – or in liquidation -- could include (1) imposing a moratoriums on contract owner’s right to redemption to stabilize the block of business, (2) suspending owners’ right of redemption, or (3) transferring the registered product business via an assumption reinsurance transaction. General guidance for receivers regarding these actions is covered in the discussion regarding *Redeemability* in Section G (4), below, and *Possible Resolution of Blocks of Business* in Section G (5), below.

1. **Liquidation**

In liquidation, the insurer is no longer in business. The receiver will handle the registered products differently as the receiver must liquidate or otherwise dispose of all of the insurer’s assets in the liquidation process. In liquidation, there will be no further sales of registered products.

Receivership statutes provide for termination of the insolvent insurer’s contracts in liquidation (subject to continuation of the covered portion of contracts by the guaranty associations) and for all parties’ rights and liabilities to be “fixed” as of a specific date (date of the insurer’s liquidation order). Distributions are made according to a priority scheme, and policyholders are paid before other unsecured creditors.

There may be direct tension between the liquidation statutes' termination of the insolvent insurers' contracts and rights fixing, and the ongoing obligations of the receiver under the federal securities laws.

1. **Life Guaranty System Triggered**

Liquidation with a finding of insolvency triggers protection from the life and health guaranty associations, assuring that at a minimum, covered policies will be honored to guaranty association levels of statutory benefits. National responses to multi-state insolvencies are closely coordinated between the receiver and National Organization of Life and Health Guaranty Associations (NOLHGA). The receiver and the guaranty associations will collaborate on issues relating to the registered products business, including the assessment of what securities laws might apply because of registered products and any separate accounts, and evaluate options for proceeding in the liquidation.

Covered policyholders are protected in insurance liquidations: (1) by guaranty associations, discussed more below; (2) by special deposits that are held separately (not as general assets) for the policyholders in states requiring such deposits; and (3) by having an absolute priority status over general and other lower level creditors under the statutory priority scheme for the distribution of general assets contained in all state receivership statutes. Covered policyholders who hold policies that, among other things, required the insurer to hold assets backing some portion of the insurer’s policy obligations in a separate account are further protected because the assets in the separate account can be used only to satisfy those insurer obligations under such policies that are supported by the separate account.

Once the guaranty association obligations are “triggered”, the guaranty association becomes responsible for covering insurance contracts and paying claims at least to the lower of: (1) the contract’s limit of coverage; or (2) the guaranty association’s statutory benefit level set forth in the guaranty association statutes. In the life and health insurance context, guaranty association statutes generally require that guaranty associations “guarantee, assume or reinsure or cause to be guaranteed, assumed or reinsured the covered policies of covered persons of the insolvent insurer”, or issue substitute or alternative policies to replace the insolvent insurer’s covered policies or contracts.

As a general matter, guaranty association statutes cover, subject to applicable maximum statutory benefit levels and other limitations/exclusions, life insurance policies and allocated annuity contracts[[11]](#footnote-11) that are issued by a properly licensed life insurer and owned by residents of their state. Guaranty association statutes generally exclude coverage for that portion of a product not guaranteed by the insurer or where the risk is borne by the contract owner.

Even if a policy or annuity is not covered, either in whole or in part by a guaranty association, the policyholder or contract holder may be protected by the policyholder-level priority status in the liquidation.

1. **Assumption Reinsurance Transaction with Solvent Insurer**

The existence of the guaranty association safety net and regulatory reforms since the 1990s generally has lessened risks for many policyholders in life insolvencies, including those with an interest in a separate account registered under the 1940 Act. The receiver and the guaranty associations (with respect to the covered policies) will most likely look for a buyer for the book of business. This would be structured as a sale of the book of business to a solvent insurer through an assumption reinsurance transaction funded by the insurer’s estate and/or the guaranty associations. No-action letter relief would likely be sought from the SEC staff in connection with a transfer of the Variable Products backed by separate accounts registered under the 1940   
Act, and also in connection with change in control issues arising from the liquidation.

In some of these transactions, contracts are restructured. Historically, separate accounts registered under the 1940 Act have not presented unique issues in these transactions, either because there were no such accounts or because the products relating to the separate account did not contain substantial general account guarantees, which helped facilitate selling the book of business (including the separate account) to a solvent insurer. This may not be the case in future insolvencies.

Where the insolvency is not entirely resolved through a transaction with a solvent insurer, the guaranty associations (with respect to covered contracts) and the insolvent insurer’s estate will fund coverage and/or payments to policyholders through enhancement plans or through the traditional liquidation claims process.

1. **Securities Laws Considerations Post-Receivership**
2. **Separate Accounts and General Account Guarantees**

Receivers recognize that a properly established, insulated separate account supporting Variable and Other SEC Registered Products must be preserved and that the assets in the separate account are insulated and ear-marked and are thus protected from the claims of general creditors in the insurer’s receivership. This is the same in both rehabilitation and liquidation.

There is a distinction between the variable contract holders’ entitlement to separate account values (right to the monetized value of their proportionate share of the assets in the separate account) and insurer general account guarantees, which are subject to claims paying ability of the insurer. These guarantees include GMWBs, GMABs, GMIBs, and GMDBs.

* Prospectuses should contain disclosure that general account guarantees are subject to the insurer's claims paying ability.

Claims associated with the insurer’s guarantee of the Variable Product are claims against the general assets of the insurer. To the extent these claims are not covered/paid by a guaranty association, the claim would be treated as a policyholder-level priority status claim in the insurer liquidation proceeding. State receivership law would control the guarantees.

General guidance: In summary, the receiver needs to identify the types of insurance products to be administered during receivership, and review and evaluate the impact of and compliance with the applicable state receivership laws and federal securities laws applicable to the insurer and its registered products and any separate accounts. The receiver must administer the separate account in the same manner as the insurer pre-receivership, and must preserve the separate account insulation.

1. **Disclosure (of Material Information)**

Securities laws require material information that might affect an investor’s view of a company to be disclosed. The SEC staff’s position has always been that it is up to the issuer to determine what is material and requires disclosure. It is likely that SEC staff would view entering into receivership (rehabilitation or liquidation) as a fact that would be material and require disclosure. Even prior to the state insurance commissioner’s action against the insurer, the insurer would normally be in communications with the SEC staff about disclosure requirements.

General guidance: Initiation of receivership proceedings necessitates filings with the SEC and disclosure to owners of the registered products. Specifically,

* Receiver should be in communication with SEC about the receivership
* Receiver will need to file updated disclosures regarding the receivership
* Receiver will need to disclose the receivership to owners of the registered products

In general, other stages of receivership that might be material and require disclosure include (1) the rehabilitation plan filing, (2) variable contract changes, (3) liquidation, and (4) transfer of book of business to solvent insurer. There may be other points that are material and thus require disclosure.

1. **Registration Statements and Prospectus Disclosure – Supplementation Requirements**

Receivers may seek guidance from SEC staff and experienced legal counsel on the need to keep current the Variable Product and Other SEC Registered Product registration statements, prospectuses and 1934 Act reports (if any) at different stages of rehabilitation. It is the responsibility of the receiver to make the determination as to what information is material (e.g., filing rehabilitation plan, etc.) and requires disclosure and a supplement of the prospectus. It is likely that SEC staff would view this information as material and that the supplement is required to be filed with the SEC and mailed to contract owners in order to put the investor on notice of the facts, including the fact that at some point, the reasonable investor needs to make a decision about further investment (premiums), transfers or withdrawals.

1. **Suspension of Sales**

In liquidation, the insurer ceases selling and stops accepting premium on all policies and contracts. The SEC staff has previously issued no-action letters in connection with the rehabilitations of Confederation Life and Mutual Benefit Life confirming it would not pursue an enforcement action for violation of the federal securities laws where, among other things, the receiver stopped accepting any new premium under existing Variable Products and stopped filing amendments to the registration statements governing the Variable Products and separate account (e.g., filing updated prospectus) with the SEC after the Rehabilitation Order had been entered in reliance on the prior SEC no-action letter in Great–West Life and Annuity Insurance Company (avail. Oct. 23, 1990). See Aetna Life Insurance and Annuity Company, Confederation Life Insurance and Annuity Company in Rehabilitation (avail. Sept. 15, 1995). A receiver would be well-advised to consult with experienced legal counsel to determine whether the circumstances they face permit reliance on these letters or other applicable relief already provided by SEC staff. If the receiver decides it cannot comply with any federal securities law requirements because any Variable Products and/or Other SEC Registered Products remain registered securities under the 1933 Act and the separate account, if registered, remains registered as an “investment company” under the 1940 Act, the receiver should consult with experienced legal counsel and then SEC staff. Note that suspending acceptance of premiums under Variable and other SEC Registered Products raises disclosure issues under the federal securities laws, that is whether the insurer had adequately disclosed previously to those considering purchasing the contract that it had reserved the right to take that action in the future.

General guidance: If the insurer suspends sales, receivers should consult with experienced legal counsel regarding the need to obtain a no action letter from SEC staff regarding not filing updated registration statements and issuing updated prospectuses.

1. **Transferring the Registered Variable Product Business**

General guidance: The receiver should be in communication with the SEC staff regarding plans to transfer a book of business to an assuming solvent insurer or plans to restructure the insurer’s registered Variable Products, and should seek necessary approvals from the SEC. No action and/or exemptive relief under the 1940 Act should be considered in connection with such a transfer and change in control issues arising from the liquidation.

1. **Continuing to “Evergreen” Prospectuses and File Required Reports**

Registration statements and other required reports generally would need to be kept up to date and filed in a timely manner with the SEC if the insurer continues to sell registered products in rehabilitation. Prospectuses would need to be kept up to date and mailed to existing contract owners.

1. **Redeemability**

The 1940 Act requirement of redeemability is a primary concern of the SEC for Registered Variable Products. Receivers may potentially request the SEC to grant an exceptive order permitting the receiver to temporarily suspend the daily redeemability requirement and defer the variable contract owners’ ability to redeem their contracts utilizing separate account assets. Administrative, technical and/or operational issues preventing the receiver from processing redemptions may necessitate a moratorium on rights of redemption.

Exemptions from the redeemability requirement are rarely granted and are narrowly tailored to address the circumstances presented. Receivers need to be aware that:

* It would be necessary to communicate with the SEC staff and experienced legal counsel regarding potential delays in payments and request an exemptive order
* Communications with the SEC staff and experienced legal counsel about what is happening and about how it is communicated to contract owners would be required
* Further, the disclosure requirement may be triggered prior to the event that results in the above issue arising

General guidance: The receiver should be in communication with the SEC staff and experienced legal counsel about any anticipated disruptions in payments or processing redemptions.

1. **Possible Resolution of Blocks of Business**

It may not be possible to arrange a “pre-packaged receivership” that results in the immediate sale/transfer of the registered product business at the time of the insurer’s liquidation order, due to the nature of products in the marketplace at the time (including guarantees provided with Variable Products). There may be a need to restructure the registered product contracts and cease accepting premiums. Note that ceasing to accept premiums on variable annuities with living benefit guarantees and on variable life insurance policies present challenging issues that are of concern to the SEC (*e.g.,* new premiums may be necessary to achieve the policy owner’s expected benefits under living benefit guarantees or to keep variable life policies in force).

Consideration also should be given to offering an exchange of the insurer’s registered product contract, or offering to buy back the insurer’s registered product contracts (e.g., offer more than the contract holder would get if they surrender but less than they would get if they died).

Determining how to proceed would depend upon the specific facts and circumstances of the company and its risk management policies, and the market at the time.

General guidance: The receiver should be in communication with the SEC staff and experienced legal counsel about any plans to restructure, transfer or exchange the insurer’s registered product contracts.

**Receivers’ Checklist**

This Receiver’s Checklist accompanies the “General Guidance for Receivers in a Future Receivership of a Troubled Insurer that Issued SEC Registered Products” (included in Chapter 9: Legal Considerations – III. G. 4. Considerations For Handling Separate Accounts, of the Receivers’ Handbook for Insurance Company Insolvencies), and is intended to assist with issue spotting and identifying areas where receivers should be in communications with the U.S. Securities and Exchange Commission (“SEC”). Receivers should be aware that insurers’ registered products are constantly evolving, and that the issues that might be encountered in a receivership of an insurer that issued registered products are likely to be different than those in prior receiverships due to the different product mixes. Receivers encountering SEC registered products in a receivership should early in the proceedings retain experienced legal counsel qualified to provide advice on the federal securities laws the rules under those laws and compliance issues, and on how state receivership laws and federal securities laws might interact in a receivership.

1. Immediately identify the types of insurance products to be administered during receivership.
2. Immediately determine whether or not products are registered with the SEC. Registered products include:

* Variable Products (variable annuities or variable life insurance policies)
  + If there are registered variable products, then any separate account supporting those Variable Products will also be subject to registration under the Investment Company Act of 1940 (“1940 Act”) and be subject to additional compliance requirements under the 1940 Act.
* Other SEC Registered Products (e.g., certain fixed annuities with market value adjustments or index-based adjustments to value).

1. Receivers should identify other interested federal regulators and establish lines of communication with them.
2. Receivers of an insurer with Managed Separate Accounts should communicate with the board of directors of that Managed Separate Account since any action taken may require board approval.

1. If insurer has registered products, immediately contact SEC staff to establish lines of communication and identify contact points for coordination.

* The SEC’s website contains contact numbers for SEC offices in Washington and for SEC’s regional offices: <http://www.sec.gov>
* Information regarding the SEC Division of Investment Management and how to contact these SEC staff may be located at: [http://www.sec.gov/investment](http://www.sec.gov/investment#.Ux2x9cLD9dh)

1. Immediately focus on SEC registered products. The federal securities laws applicable because of the insurer’s registered products vary depending on the type of product.

* Review and evaluate the impact of and compliance with the applicable state receivership laws and the federal securities laws applicable to the insurer and its registered products, in particular if the registered products are variable products with separate accounts.

For variable products,

* Determine types of separate accounts supporting the variable products and whether any existing separate account was, or was required to be, registered under the 1940 Act as either:
  + Unit Investment Trust (“UIT”), or
  + Managed Separate Account
* Determine if variable product is backed by insulated separate account not registered under the 1940 Act (“Exempt SAs”)
* Obtain and review available 1933 Act and 1940 Act registration statements and other filings
  + Obtain complete set of all SEC filings, looking for:
    - Insurer’s “Plan of Operations” or similar documentation for operation of separate account (may not be filed with the SEC).
    - Obtain all agreements with reinsurers, distributors, third party credit support providers, guarantors, administrative service providers, custodians, and investment advisors/managers involved with insurer’s maintenance of separate accounts
* Obtain and review Rule 38a-1 written compliance policies and procedures and annual compliance reports
* Obtain copies of any significant SEC orders or other relief applicable to the separate account that modifies the regulatory regime governing the account
* Determine the types of variable products and amount of the insurer’s net financial exposure
  + Locate and review all prospectuses filed with SEC and all variable product forms insurer issued
* Determine all guarantees provided with registered products, such as
  + Expense charge guarantees
  + Mortality guarantees
  + Optional guaranteed benefits, such as guaranteed death benefits (GMDBs), and guaranteed living benefits such as guaranteed minimum withdrawal benefits (“GMWBs”), guaranteed minimum accumulation benefits (“GMABs”), and guaranteed minimum income benefits (“GMIBs”)
* Determine the standards governing the guarantees
  + Based upon or determined from guaranteed return of premium, guaranteed annual interest rate return, or highest anniversary value
* Determine insurer’s financial risk not supported by separate accounts
  + Review all actuarial memoranda and analysis
* Determine insurer’s financial hedging transactions to support obligations under variable products
  + Evaluate whether hedging programs are adequate

For other SEC Registered products,

* Determine if SEC registered product is backed by an insulated separate account that is not registered under the 1940 Act (such as registered MVA, and registered index-linked variable annuities)
* Obtain and review available 1933 Act registration statements and other filings and all 1934 Act reports (Form 10-K, 10-Q and 8-K), if applicable
  + Obtain complete set of all SEC filings, looking for:
    - Insurer’s “plan of operations” or similar documentation for operation of separate account (may not be filed with the SEC).
    - Obtain all agreements with reinsurers, distributors, third party credit support providers, guarantors, administrative service providers, custodians, and investment advisors/managers involved with insurer’s maintenance of separate accounts
* Determine the types of other SEC registered products and amount of the insurer’s net financial exposure
  + Locate and review all prospectuses filed with SEC and all product forms insurer issued
* Determine all guarantees provided with other SEC registered products, such as
  + Expense charge guarantees
  + Mortality guarantees
  + Optional guaranteed benefits, such as guaranteed death benefits (GMDBs), and guaranteed living benefits such as guaranteed minimum withdrawal benefits (“GMWBs”), guaranteed minimum accumulation benefits (“GMABs”), and guaranteed minimum income benefits (“GMIBs”)
* Determine the standards governing the guarantees
  + Based upon or determined from guaranteed return of premium, guaranteed annual interest rate return, or highest anniversary value
* Determine insurer’s financial risk not supported by separate accounts
  + Review all actuarial memoranda and analysis
* Determine insurer’s financial hedging transactions to support obligations under variable products
  + Evaluate whether hedging programs are adequate

1. Determine whether from an operations standpoint the receiver should maintain the insurer’s infrastructure, compliance procedures, administrative procedures, technology, fund managers, etc.

* Obtain and review all documentation, contracts, licenses, etc., pertaining to these matters.

1. Life Guaranty System

* Collaborate with guaranty associations (through NOLHGA in multi-state insolvency) as soon as practical regarding registered products that may be eligible for guaranty association coverage, including the assessment of (i) what securities laws might apply to covered registered products and any related separate accounts and (ii) compliance and operational issues with respect to the possible continuation of covered registered products, including whether the receiver should maintain the insurer’s infrastructure, technology, product administration, fund managers and other relevant operational mechanisms

1. Explore sale of insurer’s book of business (assumption reinsurance transaction)

* Communicate with SEC staff and legal counsel regarding plans to transfer registered products book of business.

1. Securities Laws Compliance Considerations

* Separate accounts supporting variable products
  + Properly established, insulated separate accounts supporting registered products must be preserved.
  + Assets in the separate account are insulated and ear-marked and are thus protected from the claims of general creditors in the insurer’s receivership.
* General Account Guarantees regarding SEC Registered and variable products
  + Insurer’s general account guarantees are subject to claims paying ability of the insurer.
  + Claims associated with the insurer’s guarantee of the variable product are claims against the general assets of the insurer.
* SEC Registered Products with Guarantees
  + Guarantees are subject to claims paying ability of the insurer.
* Disclosure Requirements
  + Initiation of receivership proceedings and other actions taken during receivership will likely necessitate filings with the SEC and disclosure to owners of the registered products. The receiver should seek advice from legal counsel regarding what events need to be disclosed under the federal securities laws and the manner and timing of such disclosures.
* Registration Statements and Prospectus Disclosure Requirements – Supplementation Requirements
  + Receivers may seek guidance from SEC staff and legal counsel on the need to keep product registration statements and prospectuses current at different stages of receivership.
  + Suspension of Sales & New Premium
    - Consult with SEC staff and legal counsel as soon as possible in the receivership process if receiver decides it cannot comply with any federal securities law requirements, since commencement of a receivership does not terminate the registration of any contracts registered as securities under the 1933 Act or of any separate account registered as an “investment company” under the 1940 Act.
    - Consult with legal counsel regarding the need to obtain a no action letter from SEC staff regarding not issuing updated prospectuses.
    - Suspending new premiums on in-force SEC Registered Products could be problematic and should be discussed with SEC staff before implementation.
  + Transferring Registered Variable Product Business
    - Communicate with SEC staff and legal counsel regarding plans to transfer a book of business to an assuming solvent insurer.
    - No Action relief should be sought in connection with such a transfer and change in control issues arising from the liquidation.
  + Restructuring Registered Product Contracts
    - Communicate with SEC staff and legal counsel regarding plans to restructure insurer’s registered product contacts, and should seek necessary approvals from SEC staff.
  + Continuing to “Evergreen” Prospectuses and File Required Reports
    - Keep prospectuses up to date if the insurer continues to sell registered products or receive premiums in receivership.
  + Continue to comply with periodic reporting obligations of the 1934 Act.
* Redeemability
  + Communicate with SEC staff and legal counsel about any anticipated disruptions in payments or processing redemptions funded by any separate account registered under the 1940 Act.
* Resolutions of Blocks of Business
  + Where a “pre-packaged receivership” that results in the immediate sale/transfer of the registered product business is not possible, consideration should be given to:
    - Restructuring the registered product contracts and cease accepting premiums.
    - Offering an exchange of the insurer’s registered product contract
    - Offering to buy back the insurer’s registered product contracts
  + Consult with SEC staff and legal counsel regarding above implementation of above considerations.

1. This creation of federal common law under the Federal Securities Laws applies even though state law governing the creation of a separate account provides that it is not a legal entity. The result has reportedly resulted in a characterization of the “’ectoplasmic theory’ of investment companies . . . .” Jeffrey S. Puretz, *Background Information: A Primer on Insurance Products as Securities*, PLI “Securities Products of Insurance Companies and Evolving Regulatory Reform,” 39, note 21 (2012). [↑](#footnote-ref-1)
2. Dodd-Frank Wall Street Reform and Consumer Protection Act, 18 USC §5383(e) (Dodd-Frank Act). [↑](#footnote-ref-2)
3. Under Section 4 (2) (b) of the 1940 Act, a UIT may not have a board of directors. [↑](#footnote-ref-3)
4. If contract benefits are guaranteed by a third party or supported by a credit support agreement as defined by the federal securities laws, then the audited financial statements of the guarantor or credit support provider must be included in, or incorporated by reference into, the registration statement. [↑](#footnote-ref-4)
5. The staff of the SEC has taken a no action position with respect to issuers that do not distribute an updated prospectus to contract owners when the product is no longer being sold in certain limited circumstances. See Great-West Life Insurance and Annuity Company (avail. Oct. 23, 1990). However, even in such cases, current audited financial statements for the insurance company and the registered separate account must be prepared, and in some cases, mailed to contract owners each year. [↑](#footnote-ref-5)
6. But see note 5, above. [↑](#footnote-ref-6)
7. See also note 4, above. [↑](#footnote-ref-7)
8. Unregistered fixed account options are frequently included as an option in registered Variable Products. [↑](#footnote-ref-8)
9. But see note 5, above. [↑](#footnote-ref-9)
10. IRMA Section 403 provides that in the case of a life insurer, the rehabilitation plan may include the imposition of liens upon the policies of the company, if all rights of shareholders are first relinquished. A plan for a life insurer may also propose imposition of a moratorium upon loan and cash surrender rights under policies, for a period not to exceed one year from the date of entry of the order approving the rehabilitation plan, unless the receivership court, for good cause shown, shall extend the moratorium. As discussed above, a moratorium may not be feasible for variable products supported by a separate account registered under the 1940 Act. [↑](#footnote-ref-10)
11. Coverage for unallocated annuities varies in accordance with the type of arrangement involved. Unallocated annuities are beyond the scope of this Chapter. [↑](#footnote-ref-11)