

Safe Harbor – FILA is a Fixed Insurance Product

The Debate on the Status of FIA

Ever since the advent of Fixed Indexed Annuities, there has been speculation about whether or not the product category should be a security or a fixed insurance product. Both sides of the argument have merit. On one hand, FIA products do not expose the client to any loss of principal and, therefore, do not have any classically defined investment risk. As such, they should be classified exclusively as insurance products. But, on the other hand, FIA products are complex financial instruments that provide exposure to equities through derivatives, a construct that would certainly require SEC registration without the guaranteed minimum values provided by the life insurer.

Rule 151A

The debate came to a head in mid-2008 when the SEC proposed Rule 151A, which removed indexed annuity contracts from the insurance exemption of the Securities Act of 1933 if “the amounts payable by the insurer under the contract are more likely than not to exceed the amounts guaranteed under the contract.” The blowback from the life insurance industry was swift, strong and spearheaded by a lawsuit filed just one month after Rule 151A was adopted. By mid-2009, bills had been introduced in both the House and the Senate to undo Rule 151A and the District of Columbia US Court of Appeals ruled to vacate Rule 151A.

The Harkin Amendment

But the nail in the coffin of the SEC’s efforts to register FIA as a securities product was hammered in with the Harkin Amendment to *Dodd-Frank*. The Harkin Amendment instructed the SEC to “treat as exempt securities described under 3(a)(8) of the Securities Act of 1933 any insurance or endowment policy or annuity contract or option annuity contract...that satisfies standard nonforfeiture laws or similar requirements of the applicable State at the time of issue.” This created a clear and bright line for life insurers to follow – as long as the product complied with fixed standard nonforfeiture laws, then the product is exempt from SEC registration.

FILA & Fixed Standard Nonforfeiture Law

As with any other FIA product, FILA is fully compliant in both letter and spirit of the standard nonforfeiture law and passes both the retrospective and prospective tests. As such, our view is that FILA clearly qualifies for exemption from registration under the Harkin Amendment.

But even without the Harkin Amendment, we would argue that FILA is no different in terms of its ultimate risk profile than any other FIA product in terms of the potential for loss at the end of the crediting term. What sets FILA apart from other FIAs is the enhanced choice and flexibility within the long-dated crediting strategy to modify the risk and return profile *within the confines of a 0% Floor at the end of the crediting period*. That’s the unique, differentiated and compelling story of FILA.

Although FILA can exhibit similar characteristics to RILA, the core value proposition is the guaranteed principal protection that ensures FILA is fully and completely within the safe harbors of the Harkin Amendment