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REGULATION OF VARIABLE ANNUITY SALES: THE AFTERMATH OF SEC v. VALIC

The recent decision of the Supreme Court in SEC v. Variable Annuity Life Ins. Co.¹ (VALIC) has climaxed a crucial legal controversy over regulation of variable annuity sales. The decision reversed lower courts' holdings² that variable annuity contracts sold by VALIC are exempt from federal securities regulation. VALIC had insisted its contracts are "insurance."³ The immediate effect of the holding is that VALIC is now subject to SEC regulation under the Securities Act of 1933⁴ and the Investment Company Act of 1940.⁵ This note will discuss and evaluate the decision, its rationale, and significance to the states and the insurance industry with respect to future regulatory problems which may arise concerning sale of variable annuities by VALIC and by ordinary life insurance companies.

The variable annuity combines traditional insurance (annuity) concepts with mutual fund principles⁶ to solve two increasingly important problems in retirement planning—the problems of rising life expectancy and declining purchasing power of the dollar.⁷ The variable annuitant's capital is invested largely in common stocks, and the issuing company undertakes to pay lifetime periodic benefits which will vary with the investment experience of the company in managing the common stock portfolio.⁸ Basically, the variable annuity rests on the theory that cost of living fluctuates in close proportion to the long-range rise and fall of the stock market.⁹ Thus, with his interest tied to rising values of diversified stocks, the variable annuitant is

¹. 79 Sup. Ct. 618 (1959).
⁷. Average length of life in the United States has increased from 61.7 years in 1935 to 69.6 years in 1956. U.S. Dep't of Commerce, Statistical Abstract 60 (79th ed. 1958). Purchasing power of the dollar, as measured by average monthly consumer prices, has declined from a scale figure of 170.4 in 1935 to 83.2 in 1957 (using 1947-49 as a base period average of 100). Id. at 331. In other words, a retirement dollar saved from 1935 until 1957 decreased to less than half of its 1935 consumer buying power.
protected against inflation;¹⁰ if deflation occurs he is not injured, because his "real" purchasing power will remain constant.

The proponents of the variable annuity assert that wide public demand exists for these contracts.¹¹ Three "insurance companies"—of which VALIC is one—have been organized for the primary purpose of selling them and are doing so in a few states.¹² The Prudential Insurance Company, as one of several regular-line life insurers desiring to issue variable annuities, definitely plans to sell them as soon as enabling legislation is passed in its home state of New Jersey.¹³ However, sale of the contracts by insurance companies has been sedulously opposed by the securities industry because of the competitive threat to mutual fund sales.¹⁴ A part of the insurance industry, notably the Metropolitan Life Insurance Company,¹⁵ is also opposed because of the fear that low returns on variable annuities during market declines would destroy public confidence in the traditionally stable insurance industry.¹⁶

The controversy over regulation arose out of insistence by the SEC and securities industry that the variable annuity is a "security."¹⁷

¹⁰ See Morrissey, supra note 6, at pp. 77-78.
¹² The companies are VALIC and Equity Annuity Life Ins. Co. (EALIC) (chartered in the District of Columbia), and Participating Annuity Life Ins. Co. (PALIC) (chartered in Arkansas). The sale of variable annuities is permitted in Arkansas, the District of Columbia, Kentucky, North Dakota and West Virginia. Id. at pp. 111-12.
¹³ Members of Teachers Ins. and Annuity Ass’n (TIAA) have been able to purchase variable annuity contracts since 1952, through College Retirement Equities Fund (CREF), a subsidiary of TIAA. However, members must "balance" their payments between conventional and variable annuity plans. No more than fifty per cent of each premium may be applied toward the variable annuity plan. See Johnson, The Variable Annuity, 7 J. Am. Soc'y C.L.U. 67 (1952).
¹⁴ See "Met" vs. "Pru"—The Variable Annuity Touches Off a Financial Free-For-All, Barron's Jan. 23, 1956, p. 3; Business Week, supra note 11, at pp. 111, 114. See also text supported by notes 93-96 infra.
¹⁵ Morrissey, supra note 6, at p. 80.
¹⁶ See Business Week, supra note 11, at p. 114.
¹⁷ Ibid. The insurance spokesmen who oppose the variable annuity also question its economic soundness as a retirement planning instrument. They assert that past experience has not shown a true correlation between the cost-of-living index and common stock prices and that there is no assurance of any such correlation in the future. See id. at pp. 114, 118; Long, The Variable Annuity: A Common Stock Investment Scheme, 1956 Ins. L.J. 393; Pyle, The Case Against Variable Annuities, 1956 Ins. L.J. 776. See also, Morrissey, supra note 6, at p. 78.

¹⁷ "Security" is defined in the Securities Act of 1933 as "any note, stock . . . certificate of interest or participation in any profit-sharing agreement . . . investment contract . . . or, in general, any interest or instrument commonly known as a 'security'. . . ." 48 Stat. 74 (1933), as amended, 15 U.S.C. § 77b (1952).

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The SEC sought to enjoin VALIC's sales activities until that company complied with the Securities Act of 1933, which requires full disclosure of investment risks before securities are sold,\footnote{18} and the Investment Company Act of 1940, which gives the SEC regulatory authority over investment company organization and activities.\footnote{19} VALIC claimed it was exempt from those acts under sections excluding annuities and insurance companies. The Securities Act exempts from its provisions any "insurance" or "annuity" contract "issued by a corporation subject to the supervision of the insurance commissioner . . . of any State. . . ."\footnote{20} The Investment Company Act exempts any company "organized as an insurance company, whose primary and predominant business activity is the writing of insurance . . . ."\footnote{21} VALIC also relied upon the McCarran-Ferguson Act which generally proscribes federal regulation of the "business of insurance."\footnote{22} The lower courts were unable to classify VALIC's contracts either as insurance or securities,\footnote{23} but denied the injunction implying that once state insurance commissioners have subjected business to their regulation, it is the business of "insurance" for regulatory purposes.\footnote{24}

In reversing, the Supreme Court first reasoned that under the federal acts involved, the meaning of "insurance" is a federal question;\footnote{25} hence, state rulings are not decisive.\footnote{26} The majority opinion, written by Justice Douglas, then analyzed the variable annuity and recognized that it does utilize some traditional insurance and annuity principles, e.g., principal and income are liquidated actuarially over a lifetime or other period, and the company assumes the risk of mis-

\footnote{18. The Securities Act makes it unlawful to use interstate commerce facilities in the sale of securities until its requirements are met. 48 Stat. 77 (1933), 15 U.S.C. §§ 77e-(a) (1)-(2) (1952). For details on the act see notes 46-48 infra, and text supported thereby.}

\footnote{19. It is likewise unlawful for unregistered investment companies to use interstate commerce facilities in the sale of securities. 54 Stat. 802 (1940), 15 U.S.C. § 80a-7(a) (1) (1952). For details on the act see notes 49-52, 63-68 infra, and text supported thereby.}

\footnote{20. 48 Stat. 76 (1933), 15 U.S.C. § 77c-(a) (8) (1952).}

\footnote{21. 54 Stat. 793, 798 (1940), 15 U.S.C. §§ 80a-2(17), -3(c) (3) (1952).}

\footnote{22. The act states, "no Act of Congress shall be construed to invalidate, impair, or supersede any law enacted by any State for the purpose of regulating the business of insurance . . . unless such Act specifically relates to the business of insurance . . . ." 59 Stat. 34 (1945), 15 U.S.C. § 1012(b) (1952).}

\footnote{23. See Note, 42 Minn. L. Rev. 1115, 1119-20 (1958).}

\footnote{24. 155 F. Supp. at 527; 257 F.2d at 205.}

\footnote{25. 79 Sup. Ct. 618, 619-21 (1959).}

\footnote{26. Id. at 621.}
calculating mortality predictions in computing benefit payments.\textsuperscript{27} These were the features primarily relied upon by VALIC in claiming to be within the insurance exemptions of the statutes in question.\textsuperscript{28} However, the Court concluded that these insurance aspects are superficial; the variable annuity cannot be called insurance in the traditional meaning employed by Congress, because it "places all the investment risks on the annuitant, none on the company."\textsuperscript{29} Since VALIC does not guarantee any benefits payable in fixed amounts, and thus assumes no true risk in the insurance sense,\textsuperscript{30} there can be no claim of exemption from the provisions of the 1933 and 1940 acts.\textsuperscript{31}

A comparison of basic conventional and variable annuity principles will aid in evaluating the significance of the Court's decision. The conventional "insurance-type" annuity protects against the risk of outliving one's capital by guaranteeing fixed periodic payments for life.\textsuperscript{32} This is accomplished by investing the annuitant's capital in fixed-yield debt securities, such as bonds and mortgages,\textsuperscript{33} and actuarially liquidating principal and income over the remaining life of the annuitant in fixed amounts. In other words, the risk of outliving capital is shifted to the issuing company which distributes such risk among the whole annuity group with guaranteed payments calculated on the basis of mortality tables.\textsuperscript{34} The variable annuity resembles the conventional annuity in that it shifts the risk of outliving capital to the company.\textsuperscript{35} The company spreads the risk actuarially among the group on the basis of mortality tables, and guarantees each member a beneficial interest for his lifetime. However, the actual benefit payments will vary, because the variable annuitant's interest is tied directly and continuously to the over-all current value of the securities in which the company has invested his money.\textsuperscript{36} All or most of the money (after the company deducts its expense and profit\textsuperscript{37}) will

\textsuperscript{27} Id. at 621-22.
\textsuperscript{28} Id. at 620.
\textsuperscript{29} Id. at 621.
\textsuperscript{30} Id. at 622.
\textsuperscript{31} See id. 621-23.
\textsuperscript{33} See Crobaugh, Annuities and Their Uses 134 (2d ed. 1933).
\textsuperscript{34} See Harwood & Francis, Life Insurance from the Buyer's Point of View 104-05 (1941).
\textsuperscript{35} 79 Sup. Ct. 618, 621 (1959).
\textsuperscript{37} More than fifty-five per cent of the annuitant's capital is deducted for loading charges in the first policy year. An average of fourteen per cent is de-
be invested in equity securities subject to fluctuating market value and yield.\textsuperscript{38} Appreciation of the total assets through capital gains and reinvested dividends will increase the variable annuitant’s interest and thus protect him against inflation. However, either a sharp market decline or poor company management of the equities portfolio, or both, would cause the variable annuitant’s actual cash payments to be small, or possibly nothing, i.e., he bears the \textit{entire risk} of adverse investment experience.\textsuperscript{39} This fact was held decisive in the \textit{VALIC} case.

In a concurring opinion,\textsuperscript{40} Justice Brennan minutely examined the above principles and gave additional reasons which led him to join

\textsuperscript{38} See Morrissey, supra note 36.

\textsuperscript{39} To illustrate, assume that \textit{A}, at age 40, is issued a variable annuity contract under which he is to pay $50 per month until he attains age 65, at which time he will begin receiving benefit payments monthly until he dies. During the pay-in period, each of \textit{A}’s payments purchases a number of “accumulation units,” the monthly value of which will fluctuate according to the company’s investment experience, i.e., realized and unrealized capital gains and/or losses and reinvested dividends. Thus, \textit{A}’s $50 might purchase 10 accumulation units the first month, 9 the second, 11 the third, and so on.

At age 65, \textit{A} might have accumulated a total of 2,690 such units. For the purpose of computing his future benefit payments, the accumulation units are then converted into “annuity units.” This is accomplished by first converting the accumulation units into a total monetary sum based on their value at the time of the conversion. This total, together with \textit{A}’s life expectancy based on mortality tables, and an assumption that the company’s net annual investment return will be a certain rate (e.g., three and one-half per cent), determines the number of annuity units, the value of which will be payable to \textit{A} each month until he dies. This number will remain constant, but annuity units, like accumulation units, fluctuate in value according to investment experience. Each month \textit{A}’s number of annuity units (e.g., 200) will be multiplied by the value of one annuity unit at that time (e.g., $1.07) to compute his benefit payment. This illustrates a typical “deferred straight-life variable annuity.” The right to receive any further benefits expires at death.

Variable annuity contracts offered by \textit{VALIC} permit several variations in this scheme, both in the manner of pay-in and pay-out. Thus, the purchaser may make a lump-sum payment and begin receiving benefits at once, or he may defer them until a later date. He may elect to receive fixed payments as in a conventional annuity, or variable payments for a guaranteed period (e.g., life plus ten years), or he may share the benefits with another under joint and survivorship provisions. See specimen contract offered by \textit{VALIC}, appendixed in 155 F. Supp. at 529-38.

\textsuperscript{40} 79 Sup. Ct. 618, 623-33 (1959). Justice Stewart joined the concurring opinion. Justice Harlan filed a dissenting opinion, which was joined by Justices Frankfurter, Clark and Whittaker. Id. at 633-37.
the majority opinion. His reasoning may be summarized as follows: Congress exempted the business of insurance from the 1933 and 1940 statutes because it was felt that the controls imposed by those acts upon the sale of securities were not relevant to the form of "investment" known as insurance (including annuity contracts). Insurance in its common meaning involved little or no risk for the purchaser other than the risk that the company might fail to meet its fixed obligations; further, the states were then, and are today, providing a highly paternalistic type of control over insurance companies in order to assure solvency and the adequacy of reserves to meet company obligations. In contrast, federal regulation of securities sales is not inherently paternalistic; its main emphasis is upon free choice by requiring full disclosure of all pertinent facts about offered securities in order to enable investors to appraise the risks intelligently. The need for such disclosure increases with the amount of risk inherent in a transaction. The variable annuity, like a share in an open-end investment company (mutual fund), places the entire risk of investment failure upon the purchaser. Hence, federal regulation of variable annuity sales is within the clear intendment of the statutes in question. Significantly, Justice Brennan emphasized that the provisions of both the 1933 and 1940 acts are applicable to VALIC. The Securities Act of 1933 relates entirely to pre-sale disclosure procedure in interstate securities offerings. The act requires the security’s issuer to file with the SEC a registration statement containing complete information about itself, its officers and the full nature of the proposed enterprise. It further requires the issuer to distribute to buyers an SEC-approved prospectus containing essentially the same facts disclosed in the registration statement. The Investment Company Act of 1940 goes beyond mere pre-sale disclosure; it contains,
among others, provisions relating to the investment practices and
policy to be followed by companies to which it pertains. These
provisions, in Justice Brennan's view, "are of the greatest regulatory
relevance ... where the investors ... participate on an 'equity' basis
in the investment experience of the enterprise." Since the variable
annuitant participates on just such a basis, it is vitally important
that he know what type of investment policy the company will follow
in managing his interest in the portfolio. Effective checks to protect
investors and to prevent undisclosed changes in investment policy
can be provided only under the provisions of the 1940 act, because
traditional state insurance regulation "simply does not touch the
points of definition of investment policy and investment technique, and
control over investment policy changes ... that the 1940 Federal
Act provides."

The Court's holding, in terms of immediate effects, places VALIC
and its companion companies under concurrent federal and state
regulation. These companies have been operating solely under the
insurance laws of the few states in which they have been permitted
to sell. Neither the majority nor the concurring opinion contains
any suggestion that the states cannot continue to regulate as they
see fit the variable annuity's insurance features. The silence of the
decision on this point, plus its pointed recognition of the insurance
features (actuarial calculations, assumption of mortality risks, term insurance feature) seem to sanction continued state regulation.
However, whether to require VALIC-type companies to operate in
conformity to a state's insurance regulations or its Blue Sky Laws, or

50. "Salient ... provisions ... regulate the relationships between the company and its investment adviser, including fees and provisions for termination of the contract; regulate trading practices, changes in investment policy, the issuance of senior securities, proxies and voting trusts, the terms of redemption by investors of their interests in the company; regulate, in the case of periodic investment plans ... the 'sales load,' or amount of the investor's payment that does not become part of his interest in the enterprise; and provide for detailed reports to investors." Id. at 626.
51. Ibid.
52. Id. at 629.
53. Id. at 626.
56. See note 12 supra.
58. Ibid.
59. Id. at 623 n.15.
both, is manifestly a question that each state must answer on a unilateral basis. The likelihood that uniform results will be obtained seems slight in view of the amount of previous controversy at the state level. For example, many state securities administrators have indicated their belief that the variable annuity is a security subject to regulation under Blue Sky Laws. The Supreme Court's holding could lend controlling force to the arguments of those advocating Blue Sky Law regulation, for if the holding is narrowly construed to mean that the variable annuity is a "security" for all regulatory purposes, then a state quite probably would exempt variable annuity companies from its insurance laws and regulate them entirely under its Blue Sky Laws. Such a result would be undesirable in view of the fact that regulation of technical insurance principles and practices is foreign to the experience of state securities administrators. The insurance features of the variable annuity might easily be left without any effective regulation in such a state.

A related problem concerns potential conflicts which may result from superimposition of SEC controls under the Investment Company Act of 1940 upon state regulation of the variable annuity's insurance features. A considerable degree of overlap exists between the provisions of the 1940 act and most state insurance codes. Both generally contain comprehensive provisions to assure adequate company capital structures, accurate financial statements and accounting, and fair selling practices. Within these overlapping areas, some initial conflicts will undoubtedly arise. However, the 1940 act contains extensive provisions not found in insurance codes, such as sections relating to trading practices, changes in investment policy, detailed reports to investors, and "sales load" charges in the case of periodic investment


62. Proponents of the variable annuity have argued that concurrent regulation would place "onerous burdens" on companies issuing variable annuities. See Becker, Variable Annuity Contracts, Insurance or Securities?, 1958 Ins. L.J. 612, 614.


plans comparable to the variable annuity. These are largely the provisions which Justice Brennan felt must apply to VALIC. The act also gives the SEC a dispensing power to exempt any person, security, or transaction from the act's provisions if such exemption is necessary or appropriate in the public interest. The SEC may well use this power to leave room for state insurance commissioners to regulate the pure insurance features of the variable annuity within the general scope of insurance codes. At the same time, however, the SEC should clearly define its own sphere of regulative authority by promulgation of preemptive rules applicable to all VALIC-type companies operating on an interstate basis.

The major question which confronts the insurance industry in the wake of SEC v. VALIC is to what extent the holding will affect regular-line life insurance companies, such as Prudential, when and if these companies execute their announced plans to sell variable annuities. These companies are as much opposed to being federally regulated as was VALIC. Whether or not they will be able to resist successfully the SEC's efforts to control them under the federal statutes in question may depend largely upon how the VALIC decision is to be interpreted. At the outset, it should be noted that there are at least two important facts in the VALIC case which may be used as a basis for distinguishing it. First, defendant VALIC was organized and operates as a company engaged primarily in the sale of variable annuity contracts; and second, the contracts sold by VALIC are wholly variable, i.e., they guarantee no minimum fixed benefit payments, because all of the purchaser's consideration is or may be invested in equity securities. Although these two facts are interrelated, it will be helpful to consider them separately with regard to the question of whether their presence or absence might have a controlling effect in future cases.

The VALIC decision does not specifically advert to the fact that VALIC sells only variable contracts, but that fact is necessarily relevant in view of the holding that VALIC must be regulated under the Investment Company Act of 1940. VALIC sought to invoke the exemptive provision of that act which excludes any company "organized as an insurance company, whose primary and predominant business
activity is the writing of insurance . . .” (Emphasis added.) The Court’s holding that VALIC’s contracts are not “insurance” within the federal meaning meant that VALIC could not claim the exemption. However, a regular-line life insurance company selling a line of variable annuities along with its traditional varieties of insurance contracts would be in a much different position. So long as only a minor portion (presumably less than half) of its total business consisted of variable annuity sales, it would still be engaged primarily and predominantly in the writing of insurance and would fall squarely within the 1940 act’s exemption. This does not mean, of course, that all federal regulation would be precluded, for it would still be necessary to comply with the Securities Act of 193375 by filing a registration statement and issuing an SEC-approved prospectus76 before offering the variable annuities (“securities”) for sale. But these are minor requirements indeed when contrasted with the stringent restrictions and prohibitions upon company activities imposed by the 1940 act.77 Although Justice Brennan felt that the 1940 act’s controls are vitally necessary to protect holders of variable annuities,78 it does not appear that those controls could be imposed in the face of the plain language of the exemptive clause.

A more intricate question is raised by the second distinguishing fact in the VALIC case—the fact that VALIC’s contracts are wholly variable. The opinion of the Court placed major emphasis upon this fact in concluding that VALIC’s contracts are not “insurance”:

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. . . . For in common understanding “insurance” involves a guarantee that at least some fraction of the benefits will be payable in fixed amounts. (Emphasis added.)79

If an issuer invested some part of the purchaser’s consideration in fixed-yield debt securities and the remainder in equity securities, and guaranteed that “some fraction of the benefits” (corresponding to the portion invested in debt securities) would be payable in minimum fixed


76. See notes 46-48 supra and text supported thereby.

77. See notes 63-69 supra and text supported thereby.

78. See notes 51-53 supra and text supported thereby.

amounts, it appears that such issuer would qualify, within the Court's language, for the insurance exemptions. Many proponents of the variable annuity have in fact recommended some sort of "balance" in investments between debt and equity securities, although their proposals differ as to how the balancing should be accomplished. The method most heavily advocated is that of external balancing, by requiring or encouraging the individual to apportion his retirement savings between separate variable and fixed income annuities. Thus, the Prudential Insurance Company's proposal is to require that no variable annuity be issued unless the purchaser first states he has a fixed income annuity or will simultaneously obtain one. This might well be the most practical system from the standpoints of both individual and company. However, it is extremely doubtful that such a plan would exempt the issuer from SEC regulation, since the variable annuity would be a separate contract with no "fraction of the benefits" payable in fixed amounts. To fall within the Court's language, the issuer would apparently have to stipulate in the contract that some reasonable minimum portion of the variable contract's benefits would be payable in fixed amounts. To do this, it would be necessary to internally balance the annuity portfolio's assets between equity and debt securities (possibly on a fifty-fifty basis). The issuer might then guarantee that the payable benefits would be at least half what the purchaser would receive under an ordinary fixed income annuity, and thus establish the "floor" which the Court considered indispensable to a claim of insurance exemption under the 1933 and 1940 acts.

At least two serious disadvantages would be involved in any attempt to tailor an internally balanced "fixed-variable" annuity to meet the Court's language. First is the risk that the Court in a future case might interpret its language quite differently than has been assumed. It might hold that if any substantial portion of the annuitant's interest were calculable only in variable terms (i.e., according to his pro rata share in equity securities), the contract would not qualify for the insurance exemptions. The second disadvantage is economic, i.e., that internally balanced annuities might have little if any sales appeal to

81. See Kvernland, supra note 80. See also note 12 supra.
82. See Day & Melnikoff, supra note 80, at 53. Legislation proposed in New Jersey (sponsored by Prudential), which would permit insurers there to sell variable annuities, provides for balancing in this fashion. See Note, 42 Minn. L. Rev. 1115, 1135 & n.121 (1958).
84. Id. at 621-22.
many persons interested in a variable plan. Convinced that long-range inflation is built into the economy,55 such persons might well prefer to take advantage of the much higher peaks in value which an all-common-stock variable annuity would attain during periods of market climb.46 Furthermore, balanced annuities would probably be unsalable to the large group of persons who already have some type of fixed dollar retirement program, such as a conventional annuity or a share in a group pension plan.57 If half of such a person's savings were already invested in a fixed plan, he would have to place the remainder into a wholly variable annuity in order to attain a truly balanced lifetime program.48 These disadvantages, among others,9 may well cause insurers to decide against the issuance of balanced annuities, in spite of the Court's implied grant of exemption.

A further question to be considered is to what extent the decision in SEC v. VALIC will affect future state action in permitting sale of variable annuities by regular-line life insurance companies. Variable annuities have not been sold to the public in most states, by either VALIC-type or regular-line companies, because of statutory restrictions which sharply limit insurers' segregation of assets, common stock purchases and related investment activities.90 The wide divergency of opinion among the states on how sales should be regulated91 has hampered efforts to pass enabling bills.92 The movement for modifying legislation has been strongest in New Jersey93 where bills have been

85. The proponents of the variable annuity place much stress on the contention that inflation will continue. This argument is based on such factors as government price supports and deficit spending, unemployment compensation, and strong labor unions. See Address by Gordon W. McKinley, Public Hearing Before Mass. Special Comm'n for Investigation and Study of Ins. Laws, April 30 and May 1, 1957.
87. See Day & Melnikoff, supra note 80, at 52.
88. Id. at 51.
89. A further shortcoming of internally balanced annuities, from the issuer's standpoint, is that a substantial portion of fixed-yield debt securities are not readily capable of market valuation, e.g., mortgages. The securities comprising the variable annuity portfolio must have easily determinable market values in order to facilitate calculation of the annuitants' interests, both during pay-in and pay-out periods. Day & Melnikoff, supra note 80, at 52.
90. See, e.g., Mo. Ann. Stat. § 376.300 (Vernon 1949); N.Y. Ins. Law §§ 79-81, 85, 87. Only a small minority of states place no restriction upon the percentage of assets insurers may invest in common stocks. See Mehr & Osler, Modern Life Insurance 691-92 (rev. ed. 1956); Comment, 1958 U. Ill. L. Forum 466, 470 & n.31.
91. See notes 60, 61 supra and text supported thereby.
92. See “Met” vs. “Pru”—The Variable Annuity Touches Off a Financial Free-For-All, Barron’s, Jan. 23, 1956, pp. 3, 4.
93. Ibid.
introduced which would enable life insurers to sell variable annuities under the broad regulatory authority of the insurance commissioner.\textsuperscript{44} The bills also permit segregation of a special asset account to consist of equity and other securities\textsuperscript{55} (which would comprise the variable annuity portfolio). Intensive promotion of these bills in New Jersey and of similar ones in other states is expected in the future.\textsuperscript{66} However, the VALIC decision could substantially hinder passage of the bills if the states, in their reluctance to see federal regulation extended to a traditional area of state control, place an unwarranted interpretation upon the decision. To avoid misconstruction, it should first be recognized that the Court did not extend federal control to the insurance field per se, nor did it foreclose state regulation of the variable annuity's insurance features.\textsuperscript{97} Rather, it held that issuers selling contracts which place all investment risks upon the purchaser thereby invade the boundaries marked by Congress for the securities business, and federal regulation is mandatory.\textsuperscript{98} Presumably the holding applies to issuers of whatever type, but here again the distinction between VALIC-type and regular-line life insurance companies is important. VALIC primarily sells variable contracts and thus must be regulated under both the Securities Act of 1933 and the Investment Company Act of 1940. Regular-line companies are exempt under the 1940 act so long as their "primary and predominant business" is insurance.\textsuperscript{99} Thus they would need only comply with the 1933 act to issue a line of variable annuities, once statutory barriers at the state level are removed.

This would produce no significant change in the present pattern of state insurance regulation, for the states would continue to administer whatever controls are considered necessary over company organization, capital structure, investment activities, and standard contract provisions.\textsuperscript{100} In these areas the provisions of the Securities Act of 1933 have no applicability; that act merely requires issuers to make a

\textsuperscript{44} The Need for Variable Annuities, A Statement by Carrol M. Shanks, President, The Prudential Insurance Company of America, pp. 2-3, 8-10 (Prudential Press).
\textsuperscript{45} Ibid. See also Schecter, Variable Annuities—Boon or Bane?, 1956 Ins. L.J. 764, 771.
\textsuperscript{47} See text supported by notes 57-59 supra.
\textsuperscript{48} 79 Sup. Ct. 618, 621-23 (1959).
\textsuperscript{49} See text supported by note 41 supra. See also 54 Stat. 793, 798 (1940), 15 U.S.C. §§ 80a-2(a) (17), 80a-3(c) (3) (1952).
\textsuperscript{50} These are the major areas of state insurance regulation. See 79 Sup. Ct. 618, 625 & n.8 (1959) (concurring opinion). See also Mehr & Osler, Modern Life Insurance 688-93 (rev. ed. 1956); Patterson, Essentials of Insurance Law 23-32 (2d ed. 1957).
full disclosure about themselves and their contracts as part of the marketing process. Disclosure is accomplished by requiring the issuer to register with the SEC and to publish an SEC-approved prospectus containing full facts about the enterprise. Requiring regular-line life insurers to comply with this disclosure procedure in selling variable annuities would not conflict with or encroach upon the administration of state insurance laws. Most states regulate marketing practices of insurers chiefly through the licensing of insurance salesmen; licenses are revocable for miscreancies such as fraud, misrepresentation, rebating and twisting. Patently this sanction can be brought to bear only after damage has been done. The Securities Act of 1933, requiring full disclosure of risks before transactions are consummated, would enhance rather than impair the effectiveness of existing state controls.

A fact worthy of emphasis is that regular-line life insurers have been among the most active proponents of state legislative amendments to permit insurers' sales of variable annuities. As shown above, concurrent regulation of such companies by the states and by the SEC under the 1933 act poses no undue problems or hardships; but if any hardships are involved they will fall directly upon the companies and not upon the states or the public. If insurance companies desire to sell variable annuities, federal regulation, at least to the extent of the 1933 act's provisions, is now fait accompli. That act provides the necessary minimum disclosure protection to which prospective investors are entitled when they are invited to assume the entire risk of adverse investment experience. Additional protective controls, such as the ones encompassed by the Investment Company Act of 1940, can readily be imposed by the states within the paternalistic framework of state insurance regulation.

101. See note 46 supra and text supported thereby.
102. See note 47 supra and text supported thereby.
103. See note 48 supra and text supported thereby.
105. Mehr & Osler, op. cit. supra note 100, at 695-97.
106. See notes 13, 94, 95 supra and text supported thereby.
107. See notes 49-53 supra and text supported thereby.