CARLTON FIELDS

Illinois Courts: Fixed Indexed Annuities Are Not Securities

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In 2009, the Securities and Exchange Commission (SEC) attempted to regulate fixed indexed annuities (FIAs) as securities by issuing Rule 151A. Previously, FIAs were treated as exempt insurance products. After the D.C. Circuit vacated Rule 151A, the issue was largely resolved, for federal law purposes, by the Dodd-Frank Act, which, generally, clarified that FIAs that comply with certain state insurance law nonforfeiture and suitability requirements are exempt from SEC regulation. In recent years, however, the Illinois Securities Department, has asserted that FIAs are securities under the Illinois Securities Law. Two recent published opinions by Illinois appellate courts, *Babiarz v. Stearns* (June 2016) and *Van Dyke v. White* (July 2016), rejected that position and confirmed the traditional understanding that FIAs are insurance products, not securities. *Van Dyke* was an administrative review action involving a Securities Department decision that found Van Dyke, an Illinois-licensed insurance producer and investment advisor, made fraudulent recommendations to his clients concerning FIAs, which the Securities Department deemed securities. While the Securities Department did not explain this finding, in an earlier administrative proceeding, it found that an FIA was a security on the grounds that it was an "investment contract" as that term is used in the Illinois Securities Law. The trial court affirmed the decision, and Van Dyke appealed. The Appellate Court for the Fourth District reversed the trial court, focusing on the fact that the Illinois Securities Law defines securities to include a "face amount certificate" and defines "face amount certificate" to include "any form of annuity contract (*other than* an annuity contract issued by a life insurance company authorized to transact business in this State)" (emphasis supplied). Finding that the FIAs in question were annuities issued by insurance companies authorized to transact business in Illinois, the appellate court held they were not securities. The court noted that this result was reinforced by the fact that the Illinois Insurance Code specifically grants the Illinois Insurance Department sole authority to regulate the issuance and sale of variable annuities and stated that "[i]t would make little sense for the legislature to place variable annuities out of the reach of the Securities Department but then subject [FIAs] to securities regulation." The plaintiff in *Babiarz* sued the insurer and insurance producer who sold FIAs to her, alleging that the producer misrepresented and omitted material terms of the FIAs and asserting multiple causes of action, including violation of the Illinois Securities Law. The trial court granted defendants' summary judgment on the securities law claim on the basis that the FIAs were not securities. On appeal, citing the not-yet rejected

Securities Department's decisions in *Van Dyke* and an earlier administrative proceeding, plaintiff argued that summary judgment was inappropriate because the FIAs were investment contracts and thus securities under the Illinois Securities Law. The Appellate Court for the First District disagreed, but based on somewhat different reasoning than that later used in *Van Dyke*. The court focused on the fact that the FIAs were issued by a licensed insurance company, sold by a licensed insurance producer, and filed with and otherwise regulated by the Illinois Insurance Department, which took the position that FIAs are insurance products. Further, the court found that an Illinois Securities Law exemption for "[a]ny security issued by and representing an interest in or a debt of, or guaranteed by, an insurance company" applied. A plaintiff's attempt to characterize FIAs as securities under California state law was also recently rejected. See "Recent Insurer Victories in Indexed Annuity Class Actions" regarding *Abbit v. ING USA Annuity and Life* on page 11.

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