

MEMO# 26698

November 16, 2012

SEC Charges Insurance Company for Failure to Sufficiently Disclose Impact of "Cap" on Insurance Products

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TO: COMPLIANCE MEMBERS No. 24-12

VARIABLE INSURANCE PRODUCTS ADVISORY COMMITTEE No. 18-12 RE: SEC CHARGES
INSURANCE COMPANY FOR FAILURE TO SUFFICIENTLY DISCLOSE IMPACT OF "CAP" ON
INSURANCE PRODUCTS

Yesterday, the Securities and Exchange Commission ("SEC" or "Commission") settled an enforcement proceeding with an insurance company that is also a registered investment adviser ("Insurance Company") based on charges that the Insurance Company failed to sufficiently disclose the potential negative impact of a cap feature in certain optional riders offered to investors in connection with variable annuity products. [*](#) The enforcement proceeding is summarized below.

According to the Order, the Insurance Company offered two Guaranteed Minimum Income Benefit riders, "GMIB 5" and "GMIB 6" (together, "Riders"), as optional features to certain of its variable annuities. For an additional fee, the Riders would set a minimum floor for a future amount that could be applied to an annuity option (the "GMIB value"). The GMIB value would automatically increase on the contract issue date and each contract anniversary thereafter by 5% (GMIB 5) or 6% (GMIB 6), subject to certain conditions. The Insurance Company referred to these annual increases as interest credits. The GMIB riders had a "dollar for dollar" withdrawal feature. This feature meant that the GMIB value would decline only by the dollar amount of any withdrawal, so long as the withdrawal did not exceed the annual interest credit. For any portion of a withdrawal that exceeded the current contract year interest earned on the GMIB value, the Insurance Company would adjust the GMIB value downward by an amount tied to the percentage decrease in the contract value. The Insurance Company limited the growth on the GMIB value, subject to certain conditions: GMIB 5 was subject to a cap of 200%, and GMIB 6 to a cap of 250%, of the purchase payments made during the first two years.

The SEC alleged that neither the prospectuses nor the sales literature sufficiently explained that, if the GMIB value reached the cap, the GMIB value would no longer earn interest. The Order states that a disclosure that appeared in the prospectuses, for the first 11 months

that the Insurance Company offered the Riders, implied that interest would continue to accrue after the GMIB value reached the cap. According to the Order, however, if the GMIB value reached the cap, the Insurance Company would no longer credit interest to the GMIB account, and the Insurance Company would, at that point, deem every dollar withdrawn to be an excess withdrawal and reduce the GMIB value pro rata. The Order states that the Insurance Company ultimately improved its disclosures to explain the effect of taking withdrawals after reaching the cap, but not until after it has stopped offering the Riders.

The SEC alleged that a number of the Insurance Company's sales agents, wholesalers, and at least one annuity specialist at another insurance sales agency did not understand, from the Insurance Company's disclosures, that all withdrawals taken in the contract years after the GMIB value reached the cap would result in pro rata reductions of the GMIB value. The Order states that, while the Insurance Company was offering GMIB riders, there were indications that sales agents and others did not understand the effect of post-cap withdrawals on the GMIB value, which should have alerted it to the fact that its disclosures were inadequate.

In 2008, the Insurance Company ceased offering GMIB 6, and in 2009, the Insurance Company ceased offering GMIB 5. In 2009, the Insurance Company revised its prospectuses to explain the consequence of taking withdrawals after the GMIB value reached the cap. In 2012, the Insurance Company eliminated the cap on the Riders.

The SEC charged the Insurance Company with willfully violating Section 34(b) of the Investment Company Act of 1940, ordered it to cease and desist from committing or causing any violations and any future violations of that provision, and imposed a \$1.625 million penalty on the firm. The Order notes that:

In determining to not impose a greater penalty, the Commission considered that, in 2012, after the conclusion of the Division of Enforcement's investigation in this matter, [the Insurance Company] announced that it would eliminate the cap on the GMIB riders. In a prospectus supplement filed with the Commission on April 16, 2012, [the Insurance Company] disclosed that, subject to state approval, there will no longer be a maximum GMIB value for [the Riders]. By July 2012, all states had approved the removal of the maximum GMIB value. [The Insurance Company's] remedial actions guarantee that no contract owner will ever reach the cap and are intended to ensure that ultimately no contract owner will be harmed by [the Insurance Company's] violation.

Sarah A. Bessin
Senior Counsel

endnotes

*See In the Matter of Massachusetts Mutual Life Insurance Company, Administrative Proceeding File No. 3-15095 (Nov. 15, 2012) (the "Order"), available at <http://www.sec.gov/litigation/admin/2012/ic-30264.pdf>. The Respondents neither admitted nor denied the SEC's allegations.

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