No. 121452

In the

Supreme Court of Illinois

RICHARD LEE VAN DYKE,

Plaintiff-Appellee,

v.

JESSE WHITE, OFFICE OF THE
SECRETARY OF STATE, STATE OF ILLINOIS,

Defendant-Appellant.

On Appeal from the Appellate Court of Illinois,
Fourth Judicial District, No. 4-14-1109.
There Heard on Appeal from the Circuit Court of the Seventh Judicial Circuit,
Sangamon County, Illinois, No. 14-MR-305.
The Honorable **John W. Belz**, Judge Presiding.

AMICUS CURIAE BRIEF OF FIDELITY & GUARANTY LIFE INSURANCE COMPANY IN SUPPORT (IN PART) OF APPELLEE

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POINTS AND AUTHORITIES

INTEREST OF THE *AMICUS CURIAE*

In this case, a former investment adviser challenges an administrative order entered against him by the Illinois Securities Department (the "Administrative Order"), which the trial court affirmed and the appellate court reversed (the "Appellate Decision"). Fidelity & Guaranty Life Insurance Company ("F&G Life") submits this *amicus curiae* brief solely to address one isolated but critical aspect of these rulings, which is whether Fixed Indexed Annuities ("FIAs")—also referred to as equity indexed annuities—are securities. The Fourth District Appellate Court correctly determined that they are not based on the plain language of the Illinois Securities Law of 1953 ("Illinois Securities Laws"). The First, Second, and Fourth District Appellate Courts of Illinois are all in agreement that FIAs are not securities. There is no contrary decision in any other District.

The Securities Department has appealed the Appellate Decision, and asks this Court to reinstate the contrary finding in the Administrative Order. Such a ruling would be incorrect and cause permanent and substantial harm to the insurance industry, including F&G Life, its agents, and its customers. The ruling is also unnecessary because the sanctions entered against the investment adviser in the Administrative Order could be upheld without ever reaching the issue of whether FIAs are securities.

F&G Life is a major provider of FIA products deriving well over half its revenues from such products over the last fifteen years. F&G Life is strictly an insurance company that offers no securities products. Its clientele is largely middle class consisting of people near retirement or in retirement who are drawn to the stability and security of FIAs. F&G Life is licensed to offer and sell insurance products in forty-nine states (a separate subsidiary offers its products in New York) through a nationwide network of over 250 independent marketing organizations that recruit and train about 25,000 insurance agents across the country.

FIAs are annuities that guarantee principal but also offer consumers the opportunity to earn interest based on the performance of a market index such as the S&P 500, subject to certain limitations such as caps on total return. FIAs are *fixed* insurance products because, unlike variable annuities, they provide built-in guarantees protecting consumers against any loss of principal due to market fluctuations. Total FIA sales reached $60 billion in 2016 and today represent over half of *all* fixed annuity sales nationwide.[1]

At stake in this case is the very question of whether insurance companies like F&G Life can continue conducting business in Illinois without substantial disruption. FIAs are exempt from federal securities laws and are not treated as securities in any other state or jurisdiction. It is telling that even the association representing state securities regulators, the North American Securities Administrators Association ("NASAA"), which submitted an *amicus curiae* brief in this matter, does not contend that FIAs are securities.[2] If FIAs were suddenly deemed to be securities in Illinois, *and Illinois alone*, the potential consequences for F&G Life and other similarly situated insurance

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[1] Press Release, Life Ins. and Mkt. Research Assoc., Fixed Annuity Sales Hit Record $117.4 Billion in 2016 (Feb. 21, 2017) (on file at www.limra.com).

[2] NASAA is the well-established voice for state securities departments across the United States. Its *amicus* brief argues only that the Appellee should be subject to fiduciary standards based on his registration as an investment adviser. NASAA espouses that position without contending FIAs are securities, which aligns with F&G Life's position. No other state besides the Illinois Securities Department contends FIAs are securities under state law as evidenced by NASAA's silence on this point.

companies, as well as their sales forces and clients, would be dramatic. F&G Life would be forced to deal with the implications of having its mainstay product deemed a security in just one state. Among other things, this could subject the company and its agents to a whole new regulatory scheme and completely different distribution system, resulting in substantial compliance modifications, sales challenges, and burdensome costs.

This Court should affirm the appellate court's determination that FIAs are not securities and uphold reversal of the Administrative Order on this point. If the Administrative Order were reinstated, Illinois insurance companies and agents would be forced to operate under an anomalous interpretation of law that defies the plain meaning of the Illinois Securities Laws and contradicts longstanding interpretation of Illinois law that annuities issued by insurance companies are not "securities." The impact would be especially acute for the thousands of insurance agents in Illinois who have been selling FIAs for nearly two decades as insurance products, and who would suddenly face questions and risks associated with securities compliance that directly threaten their livelihood as insurance agents.

For these reasons, F&G Life submits this *amicus curiae* brief respectfully asking this Court to affirm the specific ruling contained in the Appellate Decision that FIAs are *not* securities under Illinois law.

SUMMARY OF ARGUMENT

This Court should affirm the specific ruling contained in the Appellate Decision that FIAs are *not* securities. The appellate court correctly reversed the Administrative Order on this point because the administrative ruling was fundamentally incorrect as a matter of law, the administrative ruling was not explained or supported in the

Administrative Order issued by the Securities Department, and the administrative ruling was not needed in order to enter the sanctions against the investment adviser in question.

First, as correctly determined by the Fourth District Appellate Court, the ruling in the Administrative Order cannot stand because the Illinois Securities Laws expressly provide that annuities issued by insurance companies are *not* securities. The Securities Department's position is simply wrong. The definition of "security" under Illinois law is clear that it covers "face amount certificates" which in turn are defined to include "any form of annuity contract (<u>other than an annuity contract issued by a life insurance company authorized to transact business in this State</u>) . . . ." 815 ILL. COMP. STAT. 5/2.1, 2.14 (emphasis added). This explicit carve-out for annuities issued by insurance companies has existed since 1925. Over many years, even the Securities Department has acknowledged repeatedly that the language cited above excludes annuities issued by insurance companies from securities regulation. There has been no change in law or circumstances whatsoever to support the Securities Department's newly conceived and highly strained position to the contrary. For this reason, the First, Second, and Fourth District Appellate Courts of Illinois have all uniformly confirmed that FIAs are not securities.

Second, the Administrative Order provides absolutely no explanation for why or how FIAs are securities, and therefore the Administrative Order cannot be sustained as a matter of law. The Securities Department attempts to cure this fatal defect by making new arguments in the Department's trial and appellate court briefs to support the Administrative Order. But, under established law, the courts can consider only the reasoning supplied by the Securities Department *in* its Administrative Order, and there was none. This is especially disturbing here because the ruling is a legal conclusion that flies in the face of the plain text of the applicable statute and conflicts with past pronouncements of the Securities Department. The appellate court's reversal of the Administrative Order can and should be affirmed on this basis alone.

Third, the Administrative Order need not have even reached the issue of whether a FIA is a security in order to sanction the investment adviser here. Specifically, under the Illinois Securities Laws, the Securities Department has ample authority to sanction the investment adviser in question, Richard Van Dyke ("Van Dyke"), assuming it can carry its burden of proof, without ruling that FIAs are securities. Van Dyke was a registered investment adviser, and thus subject to the jurisdiction of the Illinois Securities Department and anti-fraud provisions of the Illinois Securities Laws, even if the alleged conduct at issue did not involve a security product. Accordingly, the question of whether a FIA is a security is an academic exercise given the circumstances, and any ruling on this issue is unnecessary.

ARGUMENT

I. FIAs ISSUED BY INSURANCE COMPANIES ARE NOT SECURITIES.

As a matter of law, this Court should rule that FIAs are not securities under the Illinois Securities Laws.[3] The indisputable facts show that (A) annuities issued by insurance companies are not securities based on the plain meaning of the Illinois Securities Laws, (B) the Securities Department has long taken the position that annuities—including FIAs—are not securities, and (C) under federal law FIAs are treated as insurance and not as securities. There is absolutely no reason why the Illinois Securities Department should take an aberrant position contrary to federal law, the laws of other states, and the longstanding position of the Securities Department itself, when FIAs are fully and capably regulated as insurance products under the auspices of the Illinois Insurance Department.

A. FIAs Are Not Securities Under The Illinois Securities Laws.

A straightforward reading of the Illinois Securities Laws shows that annuities issued by insurance companies, including FIAs, are not securities. The plain language of the text is supported by analogous definitional carve-outs, the history and development of the law, and prior pronouncements of the Securities Department itself.

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[3] The Court's review of the issue presented here is *de novo*. The issue is whether annuities issued by insurance companies fall within the statutory definition of "security." There are no facts in dispute on that issue. Under the *de novo* standard, the Court's review is "independent and not deferential" to an administrative agency determination. *Hossfeld v. Ill. State Bd. of Elections*, 238 Ill. 2d 418, 423 (2010) (citation omitted). This standard applies where, as here, "the historical facts are not in dispute, and the question is a purely legal one," the dispute being in this case the meaning of the term "security." *Id.*; *see, e.g.*, *Integrated Research Servs. v. Ill. Sec'y of State, Secs. Dep't*, 328 Ill. App. 3d 67, 69–70 (1st Dist. 2002) (citation omitted) (applying *de novo* standard to determination by the Illinois Securities Department that a financial product fell within the statutory definition of "security" under the Illinois Securities Laws).

Under the Illinois Securities Laws, the term "security" is defined to include a "face-amount certificate." 815 ILL. COMP. STAT. 5/2.1. In turn, a "face amount certificate" is defined 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) . . . ." 815 ILL. COMP. STAT. 5/2.14 (emphasis added). A plain and natural construction of these definitions makes evident that annuity contracts issued by authorized life insurance companies are wholly outside the definition of "security." In this case, the FIAs in question are annuities issued by insurance companies authorized to transact business in Illinois. Hence, they are not securities under Illinois law.

The statute's plain language is amply supported by principles of statutory construction. The law presumes the General Assembly acted in a rational manner. *See Vestrup v. DuPage Cty. Election Comm'n*, 335 Ill. App. 3d 156, 161 (2d Dist. 2002) ("[A] court . . . will favor an interpretation that renders the law reasonable and sensible over one that renders the law illogical and absurd." (citation omitted)). The position of the Securities Department—that somehow the definition of "security" covers annuities issued by insurance companies even though they are explicitly carved out from the definition of "face amount certificate"—would render the law illogical and absurd for the following reasons. (*See* Appellant's Br. 26–29.)

First, the carve-out for annuities issued by insurers dates back to 1925, and the Legislature has stood by this exclusion ever since. In earlier versions of the law, the definitional carve-out for annuities issued by insurers was directly embedded in the definition of "security." The Illinois Securities Law of 1925 defined "securities" to include a long list of instruments, among them "annuity contracts unless issued by insurance companies . . . ." ILL. REV. STAT., ch. 121 1/2, § 97(1) (1951) (emphasis added).[4] In 1953, the Legislature retained but moved the annuity exclusion into the definition of "investment contract," defining investment contract 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) . . . ." ILL. REV. STAT., ch. 121 1/2, §§ 137.2(A), (K) (1953) (emphasis added). Two years later in 1955, the Legislature merely changed the term "investment contract" to "face amount certificate contract" but left undisturbed the exclusionary language for annuities issued by insurance companies. It defies logic to suggest the Illinois Legislature—given the ninety-year lineage of this definitional exclusion—ever intended that annuities issued by insurance companies should be considered "securities."

The Securities Department nevertheless argues that annuities issued by insurance companies are excluded from the definition of "face amount certificate" but still captured in the definition of "security" because they are a form of "investment contract." (Appellant's Br. 26–29.) This interpretation defies the plain text of the law and is undermined by how the law evolved over time. The definition of "security" consists of a long list of items that are considered securities, yet there is no mention of annuities issued by insurers, which are explicitly carved out of the definition of "face amount certificate." If annuities issued by insurers were to be included within the definition of "security," the

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[4] In *Rinn v. New York Life Insurance Co.*, the Seventh Circuit denied plaintiff's attempt to invoke security laws, ruling the Illinois Blue Sky Law (as securities laws are sometimes known) "did not cover annuity insurance contracts issued by insurance companies." 89 F.2d 924, 926 (7th Cir. 1937) (citing Laws Ill. 1919, p. 351, Sec. 2, as amended by Laws 1925, p. 549, Sec. i (Smith-Hurd Ill. Stats. c. 121 1/2, Sec. 97 and note; Cahill's Ill. Rev. Stat. 1929, chap. 32, par. 255)).

Legislature could have easily so indicated but did not. Principles of statutory construction dictate that specific provisions targeting a particular issue control—in this case the exclusion for annuities issued by insurers—instead of provisions that are more general in nature. *See Knolls Condo. Ass'n v. Harms*, 202 Ill. 2d 450, 459 (2002) ("It is also a fundamental rule of statutory construction that where there exists a general statutory provision and a specific statutory provision, either in the same or in another act, both relating to the same subject, the specific provision controls and should be applied." (citations omitted)).[5]

Second, other definitional exclusions in the Illinois Securities Laws clearly manifest the Legislature's intention to remove certain kinds of instruments or transactions

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[5] The intent of the law is also made transparent on this very point by the fact that the Legislature in adopting the original 1953 Act defined the term "investment contract" to exclude annuities issued by insurance companies and then in 1955 changed the term "investment contract" to "face amount certificate contract" while retaining the exclusionary language for annuities issued by insurers. Thus, the Legislature revealed its intent that this basket of instruments—first labeled "investment contract" and then re-labeled "face amount certificate contract"—in either case was intended to exclude annuities issued by insurance companies from the definition of security. While the term "investment contract" assumed a broader meaning with enactment of the 1955 Act, that broader meaning was intended to encompass other instruments but not annuities issued by insurance companies which remained explicitly excluded by virtue of the exclusionary phrase contained in the definition of face amount certificate. Quite notably, contemporary detailed analyses of the 1953 and 1955 laws make no mention of any intention to bring annuities issued by insurers within the scope of these laws. *See* SAMUEL YOUNG, HISTORY, SOURCE AND EFFECT OF THE ILLINOIS SECURITIES LAW OF 1953 AS AMENDED 568 *et seq.* (1960); *An Examination of the New Illinois Blue Sky Law*, 49 NW. U. L. REV. 781 (1955). Because it was settled at the time that annuities issued by insurers were excluded from the Illinois Securities Laws, the burden is on the Securities Department to show the Legislature intended to change the meaning of these laws. *See Green v. Bock Laundry Mach. Co.*, 490 U.S. 504, 521 (1989) ("A party contending that legislative action changed settled law has the burden of showing that the legislature intended such a change.").

from the scope of those laws. These analogous carve-outs prove that F&G Life's plain reading of the statute is the only plausible construction.

Consider the definition of "viatical investment" which—like "face amount certificate"—is another type of instrument defined as a "security." The Illinois Securities Laws include "viatical investment" in the definition of securities but then contain four enumerated exceptions within the definition of "viatical investment." 815 ILL. COMP. STAT. 5/2.1, 2.33.[6] By creating these explicit carve-outs from the definition of "viatical investment," it is undeniable that the Illinois Legislature intended for these four kinds of instruments or transactions to be wholly excluded from the definition of a "security." The Securities Department could not credibly argue that these carved-out items—for example, the sale of insurance policy benefits to a viatical settlement provider—are excluded from the definition of "viatical investment" but are still somehow subject to further analysis as to whether they might still be deemed securities because they are "investment contracts" or by some other novel theory. Unless the Legislature is presumed to have acted inconsistently, that same logic must apply to annuities issued by insurance companies, which similarly are excluded from the definition of "face amount

[6] "Viatical investment" is a defined term meaning essentially the contractual right to receive death benefits under life insurance policies. Viatical investments create a secondary market for life insurance policy benefits sold by the original policyholder or "viator" to so-called viatical settlement providers. There are four enumerated exceptions within the definition of "viatical investment" (and thus by extension four exclusions from the definition of "security") for (i) the sale of the insurance policy by the policyholder or "viator" to the viatical settlement provider, (ii) the sale of contracts among viatical settlement providers, (iii) assignment of life insurance policies as collateral, and (iv) policy loans or accelerated death benefits provided by the insurer to the policyholder pursuant to the terms of the policy. 815 ILL. COMP. STAT. 5/2.33. These exceptions exist in recognition that underlying viatical settlement and insurance policy transactions are highly regulated under insurance law under the supervision of the Illinois Insurance Department.

certificate" and thus excluded from the definition of "security" under the Illinois Securities Laws.

Third, to the extent any doubt remains that the Illinois Legislature always intended to categorically exclude any and all annuities issued by insurance companies from the Illinois Securities Laws, in 1971 the Illinois Legislature declared emphatically that variable annuities—which do not provide minimum guarantees and are the type of annuities most susceptible to being regarded as securities—fall under the sole jurisdiction of the Department of Insurance and thus are not to be regulated as securities. The Legislature inserted in the Illinois Insurance Code a provision that states, "[*n*]*otwithstanding any other provision of law*, the Director [of Insurance] has *sole* authority to regulate the issuance and sale of variable contracts . . . ." 215 ILL. COMP. STAT. 5/245.24 (emphasis added).

It simply makes no sense that the Illinois Legislature would place variable annuities (which are most like securities and in fact treated as securities under federal law) beyond the reach of the Securities Department, but nevertheless subject annuity products such as FIAs (which bear little or no resemblance to securities) to securities regulation. That would turn Illinois upside down compared to federal law and other states by making fixed annuities in Illinois subject to securities regulation but variable annuities not.[7] That anomalous reading should be rejected in favor of the plain logical

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[7] F&G Life is unaware of any other state regulatory authority asserting that FIAs are securities and certainly no ruling to that effect. Indeed, in most states annuities are explicitly excluded from the definition of "security." Under the Uniform Securities Act, some version of which is adopted in most states, the term "'Security' . . . does not include an insurance or endowment policy or annuity contract under which an insurance company promises to pay a fixed [or variable] sum of money either in a lump sum or periodically

language of the statute—that is, the complete exclusion of all annuities issued by insurance companies from the Illinois Securities Laws.

The appellate court found this logic persuasive which is now forcing the Securities Department to do contortions arguing the statute giving "sole authority" to the Insurance Department over sales of variable contracts does not really mean what it says. The Securities Department contends unconvincingly this grant of exclusive authority to the Insurance Department applies only to registration of variable annuities and not their sales. (*See* Appellant's Br. 39–45.) The Securities Department props up this fabrication because, without it, the rationale for the Securities Department to regulate the sale of FIAs, when it does not even regulate the sale of variable annuities, crumbles under the weight of the manifest intentions of the Illinois Legislature. But the arguments made by the Securities Department are specious and easily dismissed, and while rebutting them entails a bit of a detour, it is important to set the record straight on this important point.

First, the law itself on its face could not be clearer, granting exclusive authority to the Insurance Department over *both* the issuance and sale of variable contracts. The attempt by the Securities Department to argue this provision does not apply to "sales of variable contracts to individual buyers" is baseless and debunked by the fact that the Insurance Department has adopted detailed sales regulations specifically derived from this grant of authority that are designed to protect individual consumers. (*See id.* at 41.)

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for life or a specified period." UNIFORM SECURITIES ACT § 102(28)(B) (NAT'L CONFERENCE OF COMM'RS ON UNIF. STATE LAWS 2005). In most states the only issue is whether to include the optional "or variable" bracketed language which would entirely exclude insurance and annuities or whether to omit that language which would then limit the exclusion to fixed insurance and annuity products. Either way FIAs would be excluded.

For example, Chapter 1, Subchapter T, Part 1551.90 of the Illinois Insurance Regulations (Title 50) specifically addressees "Licensing of Producers for Variable Contracts" and Chapter 1, Subchapter II, Part 3117 specifically provides for "Licensing and Suitability Requirements for the Solicitation of Variable Contracts." ILL. ADMIN. CODE tit. 50, §§ 1551.90, 3117.

Second, the Securities Department seeks to make it appear the "sole authority" granted to the Insurance Department has only limited meaning restricted to carrying out provisions of Article XIV½ relating to administration of separate accounts which are established to support variable contracts. (*See* Appellant's Br. 39–41.) But that is not what the statute says which reads in its entirety as follows:

> Notwithstanding any other provision of law, the Director has sole authority to regulate the issuance and sale of variable contracts, and to promulgate such reasonable rules and regulations as may be appropriate to carry out the purposes and provisions of this Article.

215 ILL. COMP. STAT. 5/245.24. The declaration saying the Insurance Director has sole authority to regulate the issuance and *sale* of variable contracts stands on its own. It is not restricted or modified by the independent point following the comma that the Insurance Director may also adopt regulations to carry out the purposes of Article XIV½. The Securities Department takes excessive liberty with its paraphrasing by saying this means the Insurance Director is granted "sole authority to regulate the companies issuing variable contracts and the registration and maintenance of such contracts to carry out the purpose and provisions of Article XIV½." (Appellant's Br. 39–41 (internal marks omitted).) That distorts the plain text of the law giving *comprehensive* authority to the Insurance Director to regulate *both* sales and issuance of variable contracts.

Other contentions by the Securities Department in this regard are also misguided and easily dispatched. Suggesting the absence of a similar "sole authority" provision for FIAs somehow creates an opening for the Securities Department to regulate FIAs ignores that the Legislature already spoke to this issue plainly by excluding all annuities issued by insurance companies from the definition of "security."[8] (*See id.* at 40–43.) Arguing that Article XIV½ only authorizes an "order of compliance" against issuers (and not salespersons) proves nothing because that provision does not prevent the Insurance Department from exercising its ample authority to discipline any insurance agent, including an insurance agent selling variable contracts. (*See id.* at 41.) Citing a few prior administrative actions where the Securities Department's authority was neither challenged nor reviewed by any court of law likewise proves nothing. (*See id.* at 41–45.)

In short, the Illinois laws are abundantly clear that annuities issued by insurance companies are categorically excluded from the definition of security. The General Assembly acted with purpose in giving exclusive jurisdiction over virtually all insurance and annuity products to the Insurance Department (including FIAs). The Illinois

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[8] The provisions at issue are consistent and sensible. Section 2.14 of the Illinois Securities Laws broadly excludes any annuity issued by an insurance company from the definition of "security." 815 ILL. COMP. STAT. 5/2.14. Insurance Code Section 245.24 effectively exempts any variable contract—including both variable annuities and variable life insurance—from the Illinois Securities Laws by conferring exclusive jurisdiction over such products on the Illinois Insurance Director. 215 ILL. COMP. STAT. 5/245.24. Section 3(M) of the Illinois Securities Laws exempts from securities registration any kind of issuance by an insurance company—debt instruments, shares of stock, or underwritten products—but allows for regulation of the sales of such instruments, shares, or products to the extent not otherwise excluded under Section 2.14 or Section 245.23 (e.g., stock issued by an insurance company must be registered through the Insurance Department but is covered by anti-fraud provisions of the Illinois Securities Laws). 815 ILL. COMP. STAT. 5/3(M). While there is overlap, each provision operates separately, and each is a logical reflection of the Illinois Legislature's division of duties as between the Securities Department and Insurance Department.

Securities Laws and Illinois Insurance Code have been amended many times over the decades since the provisions in question were enacted and at no point has the Illinois Legislature acted to put any annuity or insurance product under the jurisdiction of the Securities Department.

B. The Plain Meaning Of The Illinois Securities Laws Is Affirmed By Past Decisions That Have Consistently Held That Annuities Issued By Insurance Companies—Including FIAs—Are Not Securities.

The plain meaning of the law is supported and reinforced by past pronouncements of the Securities Department itself. The Securities Department in the past has repeatedly affirmed that annuities issued by insurance companies are excluded from securities regulation, specifically citing the exclusionary language contained in the definition of "face amount certificate."

In 1984, the Securities Department issued a "no-action" letter stating that "*when . . . annuities are issued by an insurance company authorized to do business in this state*, those annuities are specifically excluded from and exempted from Illinois Securities Department jurisdiction" and are instead within the "sole jurisdiction of the Illinois Department of Insurance." Ill. Sec. Dep't, No-Action or Interpretive Letter on Variable Annuity Contracts (Aug. 7, 1984) (emphasis added), 1984 WL 44885 (citing 815 ILL. COMP. STAT. 5/2.14).[9] The Securities Department cited as its authority the definition of "face amount certificate." *Id.* While the no-action letter observed initially that variable

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[9] F&G Life cites prior no-action letters issued by the Illinois Securities Department to show how the position of the Securities Department in the past accorded with the plain reading of the law. F&G Life recognizes such no-action letters are not binding legal opinions of the Department (*see, e.g.*, 815 ILL. COMP. STAT. 5/15a) but they cannot be ignored as expressing the views of the agency over time on matters of statutory construction.

annuities fall within the terms of the Illinois Securities Law of 1953—which is true for annuities *not* issued by insurance companies—the no-action letter distinguished annuities issued by an insurance company authorized to do business in Illinois as being exempt and *excluded* from the Department's jurisdiction.[10] *Id.* This is exactly the position F&G Life now asks this Court to take with respect to FIAs.

In 1994, the Securities Department issued a second no-action letter restating and reaffirming the same position. The Department did so by indicating even more explicitly that annuities issued by insurance companies fall outside any requirements of the Illinois Securities Laws due to the exclusionary language found in the definition of "face amount certificate." Ill. Sec. Dep't, No-Action or Interpretive Letter on Teachers Personal Investor Services, Inc. (Aug. 22, 1994), 1994 Il. Sec. LEXIS 218. The insurance company requesting the no-action letter sought assurances from the Securities Department that its personnel selling variable annuities in Illinois would be exempt from registration under Illinois law. The Securities Department responded with the very point

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[10] The no-action letter cites both Section 2.14 which is the definition of face amount certificate (containing the exclusionary language for annuities "issued by a life insurance company authorized to transact business in this State") and Section 3(M) which is an exemption from registration for securities issued by insurers (providing exemption for "[a]ny security issued by and representing an interest in or a debt of, or guaranteed by, any insurance company organized under the laws of any state"). *Id.* (citing 815 ILL. COMP. STAT. 5/2.14, 3(M)). The letter is carefully drafted stating that variable annuities are "excluded from and exempted from" the Illinois Securities Laws and citing the corresponding code sections respectively, thus reflecting the fact that annuities issued by insurers are "excluded from" the securities laws under Section 2.14 and "exempted from" securities registration requirements under Section 3(M). *Id.* The no-action letter did not need to cite the Section 3(M) exemption since the Section 2.14 exclusion unto itself removes the need for registration, but it is apparent the author of the letter was merely being meticulous and citing all grounds for non-application of securities laws relative to these products.

that variable annuities were not securities and therefore no exemption was needed, stating:

> Based upon your representations, the staff will not recommend that enforcement action be taken if TPIS relies upon Sections 2.1 and 2.14 of the Illinois Securities Law of 1953, as amended (the "Act") . . . Section 2.1 includes face amount certificates in the definition of security. However, Section 2.14 further defines face amount certificate contracts as, among other things, any form of annuity contract "other than an annuity contract issued by a life insurance company authorized to transact business in this State."

Id. The position taken then by the Securities Department is irreconcilable with the position it now takes in this litigation.

Most recently, in 2013, the Securities Department provided a no-action letter to F&G Life stating that the Department would not recommend an enforcement action against F&G Life for FIAs issued and sold through insurance agents who are not registered to sell securities under the Illinois Securities Laws. Ill. Sec. Dep't, No-Action or Interpretive Letter on Sale of Indexed Annuity Contracts (Jan. 10, 2013), 2013 Il. Sec. LEXIS 1. While F&G Life took the position, as it does here, that FIAs are excluded from the Illinois Securities Laws, the Securities Department relied on a more narrow product exemption under Section 3(M) for securities issued by an insurance company. However, even this more narrowly tailored no-action letter, saying that FIAs can be sold by insurance agents who are not registered to sell securities in Illinois, is hard to reconcile with the position that the Department takes in this case.[11]

While recent erratic positions of the Illinois Securities Department have engendered confusion in this area, the Illinois Insurance Department has provided steady regulatory stewardship, making clear that FIAs are subject to its regulation as insurance products. The Illinois Director of Insurance issued a bulletin on April 13, 2009, stating that "annuity contracts pursuant to which benefits are dependent upon the performance of a securities or other index have been, are, and will continue to be, regulated by the Illinois Division of Insurance as insurance contracts." ILL. DEP'T OF INS. BULL. NO. CB 2009-05, INDEXED ANNUITIES ARE SUBJECT TO STATE INSURANCE OVERSIGHT AND REGULATION (Apr. 13, 2009). This oversight of annuities (including FIAs) by the Illinois Insurance Department under the Illinois Insurance Code (215 ILL. COMP. STAT. 5) and applicable regulations (ILL. ADM. CODE tit. 50) is comprehensive and pervasive, requiring formal approval of policy language, licensing and appointment of agents, solicitation and sales requirements, rules for full and proper disclosure, fair claims administration practices, investment restrictions, financial and market conduct auditing, participation in

[11] By taking a position in this lawsuit that FIAs are securities, the Department creates irreconcilable inconsistencies, one of which is its position that FIAs are securities but can still be issued and sold without registration of either the product or salespersons. The Department apparently grapples with these inconsistencies which can be glimpsed by the difference between its Notice of Hearing to Van Dyke in which paragraph 18 says "persons selling [FIAs] are exempt from securities salesperson and/or dealer registration" and its Administrative Order where it conspicuously omits that language in paragraph 18 merely declaring FIAs to be securities without clarification. The position of F&G Life is simple and straightforward, which is that individuals like Van Dyke who choose to become investment advisers subject themselves to anti-fraud provisions of Section 12(J) but that unto itself does not turn the product they sell into a security and thus there is no requirement for either the product or salespersons to be registered under the Illinois Securities Laws.

the guaranty fund for protection of policyholders in cases of insolvency, and much more. *See, e.g.*, 215 ILL. COMP. STAT. 5/132 *et seq.*, 421 *et seq.*, 531.01 *et seq.*; ILL. ADM. CODE tit. 50, §§ 909.10 *et seq.*, 1405.10 *et seq.*, 3120.10 *et seq*.

It is particularly noteworthy in this case that virtually all the alleged misdeeds by Van Dyke cited by the Securities Department constitute violations of state insurance law and fall squarely within the purview of the Illinois Insurance Department. The Securities Department's complaint is that Van Dyke recommended annuity products that were not suitable for his clients, made misrepresentations about himself and the products, and improperly replaced one annuity for another resulting in unnecessary or undisclosed losses to his clients. (Appellant's Br. 4–15.) Nothing about these allegations hinges on whether the annuity is a security and none of it has anything to do with crediting methodology which is the supposed product feature that causes the Securities Department to allege these products are securities.[12] Instead, the Securities Department raises ordinary market conduct concerns about Van Dyke that the Insurance Department routinely addresses under well-developed rules and regulations governing insurance

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[12] In its brief, the Securities Department describes its allegations and evidence against Van Dyke in painstaking detail, including analyses performed by experts to show purported harm to Van Dyke's clients. (*Id.*) What is striking about these analyses is that they assumed for control purposes that the products in question (both the original annuities and replacement annuities) would all earn 3% interest, and they focused entirely on losses caused by surrender charges and other fees. (*Id.* at 14–15.) In other words, the expert analyses relied upon by the Securities Department assumed away any issue potentially related to annuity crediting, which is the supposed "investment" component of FIAs that makes them securities according to the Department. This undercuts the rationale of the Securities Department in pursuing this case where it says, for example, that "unlike the Insurance Code, the Act is designed to address the types of concerns raised by products sold on the promise of potential investment gains." (*Id.* at 41.) Such justifications ring hollow when the allegations bear no connection to investment gains and instead entail market conduct activities subject to enforcement by the Illinois Insurance Department.

agents and their practices. The Insurance Department has promulgated comprehensive criteria for determining suitability, ensuring proper replacement of annuities, prohibiting misrepresentation, and addressing a wide spectrum of unfair trade practices. *See, e.g.*, 215 ILL. COMP. STAT. 5/421 *et seq.* (unfair methods of competition and unfair and deceptive acts and practices); ILL. ADM. CODE tit. 50, §§ 909 (advertising and sales promotion of life insurance and annuities), 917 (life insurance and annuity replacements), 3117.200 (suitability for variable life insurance policies), 3120 (suitability in annuity transactions). The Securities Department's attempt to create the impression there would be some regulatory void if FIAs were placed outside the jurisdiction of the Securities Department is untrue and belied by the very facts of this case.

Finally, all decisions in Illinois to date addressing this issue square with this analysis and conclude FIAs are not securities. The Second District was first to address this issue in *Rasgaitis v. Waterstone Financial Group, Inc.*, 2013 IL App (2d) 111112. In that case, the defendants sought to rely on a repose period contained in the Illinois Securities Laws, but the court rejected defendants' argument because "annuities are not securities." *Id.* ¶ 37.

The First District next addressed the issue in *Babiarz v. Stearns*, 2016 IL App (1st) 150988, ¶¶ 25–36. There, the court held that "FIAs are insurance products exempt from the Illinois Securities Law of 1953." *Id.* ¶ 36 (citation omitted). In its analysis, the court observed the FIAs were registered with the Illinois Insurance Department, the producer was a licensed insurance agent, and the issuer was a licensed insurance company, concluding "[i]t is apparent that, in practice, the Illinois Department of Insurance regulates FIAs." *Id.* ¶ 32. The court pointed to the 3(M) registration exemption for guaranteed insurance products (which F&G Life believes was unnecessarily narrow), but its real emphasis was on the fact "that FIAs are sufficiently regulated by the Insurance Code and the disclosure concerns underlying the Securities Law [were] not implicated." *Id.* ¶ 36.

Shortly after *Babiarz*, the Fourth District entered the Appellate Decision in this matter, *Van Dyke v. White*, 2016 IL App (4th) 141109. The Fourth District once again held that "indexed annuities are not securities under the Act." *Id.* ¶ 24. The court found that, under the Act, "the term 'security' is defined to include 'face-amount certificate'" and "face-amount certificate" is, in turn, defined as "any form of annuity contract (other than an annuity contract issued by a life insurance company authorized to transact business in this State)." *Id.* (citations omitted). The court concluded that "the indexed annuities in question are annuities issued by insurance companies authorized to transact business in Illinois. Thus, they are not securities under Illinois law." *Id.* The court said that "[t]o hold otherwise would go against the plain language of the Act." *Id.*

The Fourth District further explained that its finding was bolstered by the fact that the Illinois Legislature declared variable annuities fall under the sole jurisdiction of the Department of Insurance, observing "[i]t would make little sense for the legislature to place variable annuities out of the reach of the Securities Department but then subject annuity products such as indexed annuities to securities regulation." *Id.* ¶ 25. The Fourth District further found the Department's administrative ruling that indexed annuities are securities lacked any reasoned rationale in its Administrative Order, indicating such a defect in the record could not be cured by *post hoc* rationalizations offered in the briefing of the case.[13] *Id.* ¶ 26 (citation omitted).

In sum, there is presently universal agreement and understanding that annuities issued by insurance companies, and in particular FIAs, are not securities under Illinois law. Instead, FIA products are issued and sold under the regulatory auspices of the Illinois Department of Insurance. There is no justification or basis for the position now taken by the Securities Department that threatens to upset an exclusion from the Illinois Securities Laws that has been on the books for nearly a century.

C. Federal Law Treats FIAs As Insurance Products And Not As Securities.

FIAs are not treated as securities under federal law. While there are technical differences between federal and state securities laws, Illinois should follow federal law in this regard to avoid turning Illinois into an island of regulatory uncertainty.[14]

Federal securities laws clearly state that insurance and annuity products issued by state-regulated insurance companies are exempt from securities regulation. 15 U.S.C. §

[13] The Fourth District determination that the Administrative Order lacked any reasoned rationale is discussed further in Section II of this brief, *infra*.

[14] Federal securities laws are conceptually different from state securities laws in the treatment of annuities. Federal securities laws regard annuities and other insurance products as securities but *exempt* them under Section 3(a)(8) of the Securities Act of 1933. Illinois law is different because annuities issued by insurance companies are *carved out* from the definition of securities in the first instance and thus are *wholly excluded* from the law, not merely "exempt." There is no room under Illinois law for finer analysis as to whether certain annuities might still somehow be securities as urged here by the Illinois Securities Department. The distinction between federal and state law is especially important here for the very reason the Illinois Securities Department now contends certain insurer-issued annuities are *exempt* for some purposes (*e.g.*, registration) but still covered by the Illinois Securities Laws for other purposes (*e.g.*, anti-fraud enforcement), when in fact annuities issued by insurance companies are *excluded* from the Illinois Securities Laws.

77c(a)(8). Despite this exemption, over time courts have ruled that certain *variable* insurance and annuity products are subject to federal securities regulation. But those court rulings do not apply to FIAs. To the contrary, based on clarifying legislation, federal law is settled that FIAs are exempt from securities regulation.

Indeed, the SEC tried and failed in its efforts to apply securities laws to FIAs just a few years ago. In *American Equity Investment Life Insurance Co. v. SEC*, 613 F.3d 166 (D.C. Cir. 2010), the United States Court of Appeals for the District of Columbia Circuit considered SEC Rule 151A, which was a SEC rule designed to treat FIAs as securities. The court vacated Rule 151A on the grounds that, among other things, the SEC failed to adequately analyze whether existing regulations on FIAs, under state insurance laws, were sufficient. *Id.* at 167–68, 177–78. The court found that the SEC had not justified placing an additional regulatory burden on the FIA industry. *Id.* at 177–78.

Not long after that, Congress passed the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, containing the "Harkin Amendment," to affirm that fixed insurance and annuity products meeting certain criteria are to be treated by the SEC as exempt securities and thus not subject to securities regulation. Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 989J, 124 Stat. 1376, 1949–50 (2010). Senator Tom Harkin of Iowa made numerous floor and committee speeches in favor of this legislation expressing the intent to preserve state insurance regulation by creating a safe harbor for FIAs and any other annuity or life insurance policy meeting the criteria set forth in the Harkin Amendment.[15] FIAs issued by insurance companies in Illinois meet all these criteria and thus FIAs are not treated as securities under federal law.[16]

Early versions of the legislation offered in the Senate (S. 1389) and House (H.R. 2733) titled the "Fixed Indexed Annuities and Insurance Products Classification Act of 2009," stated that the purpose of the legislation was to "clarify the scope of the exemption for annuities and insurance contracts from Federal regulation under the Securities Act of 1933." This one-two punch in 2010, with the D.C. Circuit first vacating Rule 151A, and then Congress adopting legislation clarifying FIAs are insurance products exempt from federal securities regulation, ratified the status of these products, which had long been presumed to be exempt from federal securities laws, as indeed being

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[15] *See, e.g.*, *Conference on Financial Regulations Bill: Hearing Before the H. Comm. on Financial Services & S. Comm. on Banking, Housing and Urban Affairs*, 111th Cong. (June 22, 2010) (statement of Sen. Tom Harkin) ("This is the Amendment that basically provides fixed index annuities be treated as insurance products, regulated by state insurance regulators."), https://www.c-span.org/video/?294185-2/conference-financial-regulations-bill-day-5-part-2&start=13381 (last visited Jan. 5, 2018).

[16] Those criteria are that (i) the annuity account value must not be derived from a separate account, (ii) the annuity must satisfy state non-forfeiture requirements, and (iii) the annuity sale must meet model suitability requirements promulgated by the National Association of Insurance Commissioners (NAIC). These criteria are designed to distinguish fixed insurance and annuity products from variable products. Variable products invest policy proceeds in separate accounts that fluctuate based on investments contained in the separate accounts. Variable products do not comply with state non-forfeiture laws which require the insurer to guarantee minimum account values and rates of return. FIAs satisfy both of these criteria. The suitability sales requirement is satisfied by the annuity being issued in a state that has adopted the NAIC model regulation, being issued by a company domiciled in a state that has adopted the NAIC model regulation, or being issued by a company that on its own adopts and implements nationwide the requirements of the NAIC model regulation. The Illinois Insurance Department adopted the NAIC model suitability regulation in 2011 to satisfy the sales component of the Harkin Amendment. ILL. ADM. CODE tit 50, § 3120.

outside the purview of federal securities laws. Had there been doubt in that regard, all doubt was removed, and it is clear today that FIAs are and remain exempt from federal securities laws.

In its briefs, the Illinois Securities Department has argued that the federal statutory exemption for FIAs should be ignored. (*See* Appellant's Br. 29–33.) Instead of embracing the federal law's treatment of FIAs as exempt securities, the Securities Department engages in a tortured analysis of federal case law based on the premise that Illinois law is different from federal law because there is no statutory exemption for annuities similar to the Harkin Amendment. (*See id.*) Of course—as explained above—the Securities Department completely ignores the plain language of the Illinois Securities Laws excluding annuities issued by insurance companies, which obviates the need for a Harkin-like amendment (that is, annuities issued by insurance companies are already categorically excluded under state law so there is no need for further clarification as provided by the Harkin Amendment under federal law).[17]

Even that aside, the logic of the Securities Department's argument is fundamentally flawed with respect to its analysis of federal case law, including *Variable Annuity Life Insurance Co. (VALIC) v. National Ass'n of Securities Dealers, Inc.*, 359 U.S. 65 (1959), and its progeny. The Securities Department brief works hard to prove

[17] Ironically the Securities Department urges this Court to follow federal law concerning the definition of "security" and "investment contract" but only to the extent that serves its own purpose. (*See id.* at 27–29.) The Securities Department goes to great lengths to explain that Illinois courts follow federal law in determining whether certain financial arrangements constitute securities such as oil drilling (*Daleiden v. Wiggins Oil Co.*, 118 Ill. 2d 528 (1987)) and cattle breeding (*Ronnett v. American Breeding Herds, Inc.*, 124 Ill. App. 3d 842 (2d Dist. 1984)). (Appellant's Br. 27–29.) But the Department turns a blind eye to federal laws that clarify FIAs are not to be treated as securities.

that FIAs should be considered "investment contracts" subject to federal securities law. (Appellant's Br. 31–33.) But that is indisputable (albeit irrelevant) because *all* annuities are investment contracts under federal securities law. That is not in question. The only question under federal law (as opposed to Illinois law) is whether the exemption for annuities under Section 3(a)(8) of the Securities Act of 1933 should be applied to certain types of annuities (*i.e.*, variable annuities). The Securities Department's core argument that annuities are investment contracts thus proves too much, for it would subject all annuities to the Illinois Securities Laws, including even the most traditional declared rate annuities—a position not even the Securities Department can suggest is tenable.

The Securities Department position is also flawed because it fails to recognize that the federal cases are interpreting an exemption under federal securities law, not state securities law. The courts are emphatic on that point. In the seminal case, *VALIC*, the Court states:

> We deal, however, with federal statutes where the words 'insurance' and 'annuity' are federal terms. . . . It is apparent that there is no uniformity in the rulings of the States on the nature of these 'annuity' contracts. In any event how the State may have ruled is not decisive. For, as we have said, the meaning of 'insurance' or 'annuity' under these Federal Acts is a federal question.

VALIC, 359 U.S. at 69. The Supreme Court and other courts addressing this issue of whether certain annuity products fall outside the exemption for annuities under Subsection (a)(8) of the Securities Act of 1933 are focused singularly and solely on the federal scheme of exemptions.[18] The construct of the federal securities laws is inherently different from state securities laws and any attempt to apply holdings of federal case law focused on a unique federal exemption to a state law exclusion is misplaced.

In its briefs, the Securities Department goes through that line of cases addressing whether various annuity products—mostly variable annuities—should be considered securities under federal law. (Appellant's Br. 29–33.) Those cases are not pertinent here, not only for the reasons explained above, but also because none of them involve FIAs and, in the final analysis, Congress has clarified treatment of FIAs under the Harkin Amendment. *See, e.g.*, *VALIC*, 359 U.S. 65; *Otto v. Variable Annuity Life Ins. Co.*, 814 F.2d 1127 (7th Cir. 1986). In the only cases on point that actually considered FIAs, the federal courts held that FIAs are insurance products exempt from federal securities laws. *See, e.g.*, *Ming Chu Wun v. N. Am. Co. for Life & Health Ins.*, No. 2:11-CV-00760-KJD,

[18] There is yet another false premise underlying the argument of the Securities Department in its attempt to cite federal case law interpreting the Securities Act of 1933. The Securities Department's argument rests on an assumption that the Illinois Legislature in the 1950s lacked awareness that the term "annuity" could include anything other than traditional fixed annuities. The federal case law, starting with *VALIC*, seeks to divine the intent of Congress when it adopted the securities laws in the 1930s, prior to the advent of variable annuities. It is that exploration into congressional intent from the 1930s that fuels the *VALIC* line of cases. However, by 1952, the first variable annuity in New York was introduced and by the mid-1950s the sale of variable annuities was beginning to spread across the country. *See, e.g.*, *VALIC*, 359 U.S. at 69; *Hearing Before the S. Comm. on Aging*, 91st Cong. 56–62 (Apr. 29–30, 1969) (statement of Dr. William Greenough, Chairman, Teachers Ins. & Annuity Ass'n & Coll. Ret. Equities Fund). One cannot equate congressional intent in the 1930s with intent of the Illinois Legislature in the 1950s concerning the meaning of the term "annuity," and thus any attempt by the Securities Department to build its argument on federal case law interpreting federal enactments from the 1930s is flawed. As noted elsewhere in this brief, were there remaining doubt, the Illinois Legislature settled the matter for good in 1971 when it conferred exclusive authority over variable annuities on the Illinois Insurance Department, thereby proving it always intended the exclusion for "annuities issued by a life insurance company authorized to transact business in this state" to encompass all annuities whether "traditional" or not.

2012 WL 893750, at *2 (D. Nev. Mar. 15, 2012) (following *Malone* and holding FIA at issue was regulated by the state insurance department and exempt from federal securities laws); *Malone v. Addison Ins. Mktg., Inc.*, 225 F. Supp. 2d 743, 749–51 (W.D. Ky. 2002) (holding FIAs at issue were exempt from federal securities laws based on a detailed analysis of *VALIC* and *SEC v. United Benefit*, 387 U.S. 202 (1967)).

The simple fact is that FIAs are annuities issued by insurance companies. Because annuities issued by insurance companies have been excluded from securities regulation in Illinois for nearly a century, which the Securities Department has long acknowledged, the Securities Department's current position runs contrary to established law. Nothing in federal law compels a different outcome, and in fact federal law is settled that FIAs are not securities. This Court should, therefore, affirm the ruling contained in the Appellate Decision holding that FIAs are *not* securities under the Illinois Securities Laws.

II. THE RULING OF THE SECURITIES DEPARTMENT THAT FIAs ARE SECURITIES LACKS ANY REASONED EXPLANATION IN THE ADMINISTRATIVE ORDER AND SHOULD BE VACATED ON THAT BASIS ALONE.

The ruling at issue here as contained in the Administrative Order may be vacated on independent grounds. It is black-letter law that the "grounds upon which an administrative order must be judged are those upon which the record discloses that its action was based." *SEC v. Chenery Corp.*, 318 U.S. 80, 87 (1943). This Court has acknowledged federal precedent supporting the view that "an administrative decision will not be upheld on grounds different from those expressed by the agency itself in its decision." *Citizens Util. Co. of Ill. v. Ill. Commerce Comm'n*, 124 Ill. 2d 195, 211 (1988). Arguments made for the first time in the briefs of the agency in court proceedings may not be used to support the agency's action because "courts may not accept appellate counsel's *post hoc* rationalizations for agency action." *Burlington Truck Lines, Inc. v. United States*, 371 U.S. 156, 168 (1962).

Contrary to the Security Department's assertions, this rule applies not only to the agency's factual findings, but also to the agency's reasoning and application of the law. *See Encino Motorcars, LLC v. Navarro*, 136 S. Ct. 2117, 2127 (2016) ("It is not the role of the courts to speculate on reasons that might have supported an agency's decision. '[W]e may not supply a reasoned basis for the agency's action that the agency itself has not given.'" (citations omitted)); *Roman v. Cook Cty. Sheriff's Merit Bd.*, 2014 IL App (1st) 123308, ¶ 82 ("We agree with the *Medina* court that an agency should adequately articulate the bases for its action, showing a rational connection between the facts found and the choice made, in order that we may conduct a meaningful review of the issues.").

Hence, agency action can be sustained only upon the reasoning and analysis of the agency as found in the administrative order, and a reviewing court "may not supply a reasoned basis for the agency's action that the agency itself has not given." *Island Lake Water Co. v. Ill. Commerce Comm'n*, 65 Ill. App. 3d 853, 856 (2d Dist. 1978) (quoting *Bowman Transp., Inc. v. Ark.-Best Freight Sys., Inc.*, 419 U.S. 281, 285–86 (1974)); *see Safe Air For Everyone v. E.P.A.*, 488 F.3d 1088, 1091 (9th Cir. 2007) ("[R]eview of an administrative agency's decision begins and ends with the *reasoning* that the agency *relied upon in making that decision* . . . ." (emphasis added)). Accordingly, this Court must evaluate the decision determining that FIAs are securities based exclusively on whatever reasoning the Securities Department supplied in its Administrative Order, not in its briefing for the trial court or on appeal.

As the detailed analysis above demonstrates, the Illinois Securities Laws provide that FIAs are not securities. In comparison, the Administrative Order is devoid of any explanation or reasoning for why the Department concludes FIAs (which it summarily denotes with capital letters as "Indexed Annuities" without definition) are securities, not even explaining what it considers a FIA to be. The Department's entire "explanation" as to why FIAs are securities is contained in paragraph 18 of the Administrative Order, which provides merely:

> The Indexed Annuities that are the subject of this Matter are securities subject to the Act. Although an Indexed Annuity is exempt from registration with the Department, the offer or sale of an Indexed Annuity is still subject to the other provisions of this Act.

(Administrative Order at 4, ¶ 18.) That explanation is no explanation at all: it is *ipse dixit*—an assertion made but not proven. *Medina Nursing Ctr., Inc. v. Health Facilities & Servs. Review Bd.*, 2013 IL App (4th) 120554, ¶¶ 24, 27 ("The necessity for administrative agencies to provide a statement of reasons . . . is a fundamental principle of administrative law." (citation omitted)) (vacating agency order containing a bald legal conclusion and remanding "to have the Board issue a reasoned opinion"); *see also St. Vincent Randolph Hosp., Inc. v. Price*, 869 F.3d 510, 513 (7th Cir. 2017) ("[U]nder the *Chenery* doctrine an administrative decision stands or falls on the agency's explanations . . . . When the agency just asserts an ipse dixit [instead of providing any "rule or equivalent legal standard"], then the decision falls for the lack of a reason." (citation omitted)); *Phila. Gas Works v. F.E.R.C.*, 989 F.2d 1246, 1250 (D.C. Cir. 1993) ("*Chenery*[] . . . applies equally when the agency gives an inadequate explanation for its conclusions." (citations omitted)). The Securities Department does not explain what a FIA is, why FIAs fall within the definition of "security," or why it departed from the long-standing and widely held view that annuities issued by insurance companies fall outside the definition of "security" and are regulated instead as insurance products.

The Securities Department's failure to give any reasoning is especially egregious where, as here, the decision represents a dramatic departure from its prior, decades-old position and could have a widespread impact on the insurance industry in Illinois. Given the Department's failure to provide any rationale—and in particular the Department's change in position—this Court should affirm the Fourth District Appellate Court's decision because "an agency rule would be arbitrary and capricious if the agency . . . entirely failed to consider an important aspect of the problem." *Motor Vehicle Mfrs. Ass'n of U.S., Inc. v. State Farm Mut. Auto. Ins. Co.*, 463 U.S. 29, 43 (1983).

This Court should further consider whether any determination by the Securities Department concerning the definition of what is a security should be done by rulemaking rather than through a disciplinary action, as a matter of due process and as contemplated under Section 11 of the Illinois Securities Laws (815 ILL. COMP. STAT. 5/11(A)(1)). There, authority is granted to the Securities Department to make such rules and regulations as may be necessary to carry out the laws, "including rules and regulations . . . defining any terms, whether or not used in this Act, insofar as the definitions are not inconsistent with this Act." *Id.* That is exactly what the Securities Department purports to do here by attempting to define securities to include FIAs. In at least one instance that has close parallels to this case—where an agency took a novel position with widespread impact based on a strained legal interpretation—the court ordered the agency to proceed with rulemaking as opposed to an isolated action against a single party. *See Ford Motor Co. v. F.T.C.*, 673 F.2d 1008 (9th Cir. 1981). While F&G Life believes defining FIAs to be securities is inconsistent with the Act, if the agency wishes to proceed in this direction, it should do so by rulemaking so affected parties have the opportunity to comment on and challenge such rulemaking through established administrative process.

In line with the above authority, the Fourth District Appellate Court in this matter recognized that "the Department's ruling that indexed annuities are securities lacks any reasoned explanation in its administrative order." *Van Dyke*, 2016 IL App (4th) 141109, ¶ 26. The appellate court confirmed that "[a]rguments made for the first time on appeal may not be used to support the agency's action because 'courts may not accept appellate counsel's post hoc rationalizations for agency action.'" *Id.* (citation omitted). The appellate court further noted "[t]he necessity for administrative agencies to provide a statement of reasons . . . is a fundamental principal of administrative law." *Id.* ¶ 28 (citation omitted). The appellate court found that the Securities Department failed to satisfy this fundamental requirement because the Administrative Order "fails to explain what an indexed annuity is, why indexed annuities fall within the definition of 'security,' or why it departed from the statutory language that annuities issued by insurance companies fall outside the definition of 'security' and are regulated instead as insurance products." *Id.* The appellate court further made note of the fact the Department attempted to "define securities to include indexed annuities in a disciplinary proceeding, as opposed to the rulemaking process that would be subject to comment and challenge." *Id.*

In short, as the appellate court correctly recognized, the Administrative Order gives no reasoning to support its dubious conclusion that FIAs are securities. This failure cannot be cured by *post hoc* arguments proffered by counsel for the Securities

Department for the first time in briefs to the courts. Under well-established administrative law jurisprudence, the Securities Department's naked and unsupported determination that FIAs are securities cannot be sustained, and the appellate court's ruling should be affirmed.

III. THE DETERMINATION THAT FIAs ARE SECURITIES IS UNNECESSARY TO DECIDE WHETHER THE INVESTMENT ADVISER IN QUESTION VIOLATED ILLINOIS SECURITIES LAWS.

The issue of whether FIAs are securities need not even be reached in this case. The Securities Department's allegations against Van Dyke are based on violations under multiple sections of the Illinois Securities Laws. The lynchpin section—12(J)—requires no ruling that a security be at issue for sanctions to be imposed on Van Dyke in his capacity as an investment adviser subject to the Illinois Securities Laws.

The Securities Department agreed with this position in the litigation in the lower court, asserting that even if there was no security sold by Van Dyke, he was still properly found to be in violation of Section 12(J) based on his status as an investment adviser and that such violations support the sanctions imposed upon Van Dyke in the Administrative Order. The trial court upheld the specific finding of a violation of Section 12(J). The appellate court likewise found that, as a result of acting "both as a registered investment advisor under the Act and as a licensed insurance producer under the Insurance Code," Van Dyke "was subject to the legal duties under each regulatory regime, including the Act's antifraud provisions" of Section 12(J). *Van Dyke*, 2016 IL App (4th) 141109, ¶ 30.

It is noteworthy the appellate court ruled against the Securities Department strictly on grounds that the Department failed to carry its evidentiary burden showing Van Dyke committed fraud in violation of Section 12(J). The appellate court ruled the Department's decision against Van Dyke was arbitrary, capricious, and against the manifest weight of the evidence. The Department now challenges the ruling by arguing the appellate court applied the wrong standard based on suitability considerations, rather than an alleged fiduciary duty. (Appellant's Br. 45–62.) F&G Life takes no position in that regard. F&G Life maintains only that the issue of whether a FIA is a security need not be reached because Section 12(J) is available to the Securities Department to discipline Van Dyke based on his status as an investment adviser, leaving only the question of whether the Securities Department has proven fraud to support its sanctions against Van Dyke.

Section 12(J) prohibits registered investment advisers from engaging in any "act, practice, or course of business" that is "fraudulent, deceptive or manipulative." 815 ILL. COMP. STAT. 5/12(J)(3). Unlike other provisions of Section 12 of the Illinois Securities Laws, there is no requirement under Section 12(J) that the alleged misconduct involve the sale of a security. The breadth of Section 12(J) is appropriate because investment advisers accept a fiduciary standard of care and thus their relationship with clients are held to a higher standard of trust as compared to salespersons.

Under parallel federal laws governing investment advisers, the SEC has made clear that sanctions may be imposed under the anti-fraud provisions of the Investment Advisers Act of 1940 even though the conduct does not involve a securities transaction. *See* Applicability of the Investment Advisers Act to Financial Planners, Pension Consultants, and Other Persons Who Provide Investment Advisory Services as a Component of Other Financial Services, Exchange Act Release No. 1092, 39 SEC Docket 494, 1987 WL 112702, at *9 (Oct. 8, 1987). In that release, the SEC cites a case in which it suspended an investment adviser's registration based on having misled clients to provide guarantees and post securities as collateral for purposes of obtaining bank loans. *Id.* at *9 n.33 (citing *In re Ronald B. Donati, et al.*, Investment Advisor Act Release Nos. 666 & 683 (Feb. 8, 1979 and July 2, 1979 respectively)). Separately, federal courts have commented that violations of investment adviser anti-fraud provisions, unlike alleged violations of the Securities and Exchange Act of 1934, need not be "in connection with the purchase or sale of any security," *Abrahamson v. Fleschner*, 568 F.2d 862, 877 (2nd Cir. 1977), nor "in connection with the provision of investment advice," *SEC v. DiBella*, No. 304-cv-1342, 2005 WL 3215899, at *8 (D. Conn. Nov. 29, 2005).

The Court's ruling on Section 12(J) is dispositive in this case (aside from whether the Department can actually prove fraud) because the Section 12(J) allegations fully encompass the alleged misconduct of Van Dyke. In other words, the core factual findings of misconduct attributed to Van Dyke constitute violations of Section 12(J) and thus the other cited subsections of Section 12—Sections 12(A), 12(F), 12(G), and 12(I)—which require that a security be involved are superfluous. Specifically, those other sections are as follows:

- Section 12(A) is a generic prohibition against violations of the act;
- Section 12(F) applies to conduct that works or tends to work "fraud or deceit" upon purchasers or sellers of securities;

- Section 12(G) applies to any "untrue statement" of a material fact or a material omission when selling securities; and
- Section 12(I) applies to any "device, scheme or artifice to defraud" in connection with the sale or purchase of securities.

815 ILL. COMP. STAT. 5/12(A), (F), (G), (I). All conduct of Van Dyke at issue in this case, if found to violate these other sections, would also violate the prohibition of Section 12(J) against "fraudulent, manipulative, or deceptive" behavior, regardless of whether securities are at issue. As explained above, F&G Life takes no position on whether the Securities Department has met its burden to establish an actual violation of Section 12(J) in this case, but that burden is the same here regardless of which subsection forms the basis for the Department's allegations.

Under these circumstances, the Court simply need not reach the issue of whether FIAs are securities. As the Illinois Supreme Court has stated, "courts in Illinois do not decide moot questions, render advisory opinions, or consider issues where the result will not be affected regardless of how those issues are decided." *People v. Alfred H.H.*, 233 Ill. 2d. 345, 351 (2009); *see also Gracia v. Volvo Europa Truck, N.V.*, 112 F.3d 291, 298–99 (7th Cir. 1997) (concluding that when one argument presents an independent basis to affirm an order, "alternative arguments" that the "decision be affirmed on other grounds" are then "moot and need not [be] analyze[d]").

Accordingly, this Court should either affirm the appellate court's ruling that FIAs are not securities for the reasons explained above, or in the alternative, this Court should refrain from deciding the issue on the grounds that it does not affect the results of the proposed sanctions against the investment adviser in this case (while making clear that the Court is not ratifying the position of the Securities Department that FIAs are securities).

CONCLUSION

In sum, the Fourth District Appellate Court's ruling must be affirmed because the ruling contained in the Administrative Order holding that FIAs are securities is legally erroneous, is not the product of reasoned decision making, is not necessary to render a judgment in the case, and will cause extreme hardship for the FIA industry and its customers in Illinois. F&G Life respectfully asks the Court to affirm the Appellate Decision with respect to this specific ruling that FIAs are *not* securities under the Illinois Securities Laws.

Dated: January 11, 2018

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CERTIFICATE OF COMPLIANCE

I certify that this brief conforms to the requirements of Rules 341(a), (b) and 345(b). The length of this brief, excluding the pages contained in the Rule 341(d) cover, the Rule 341(h)(1) statement of points and authorities, the Rule 341(c) certificate of compliance, and the certificate of service is 37 pages.

/s/ Julie L. Young
Julie L. Young

NOTICE OF FILING and PROOF OF SERVICE

In the Supreme Court of Illinois

RICHARD LEE VAN DYKE, *Plaintiff-Appellee,* v. JESSE WHITE, OFFICE OF THE SECRETARY OF STATE, STATE OF ILLINOIS, *Defendant-Appellant.*	))))))))))	No. 121452

The undersigned, being first duly sworn, deposes and states that on the 11th day of January, 2018, there was electronically filed and served upon the Clerk of the above court the *Amicus Curiae* Brief of Fidelity & Guaranty Life Insurance Company in Support (In Part) of Appellee, and that on the same day, a pdf of the same was e-mailed to the following counsel of record:

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Within five days of acceptance by the Court, the undersigned states that he will send to the above court thirteen copies of the *Amicus Brief* bearing the court's file-stamp.

/s/ Julie L. Young
Julie L. Young

Under penalties as provided by law pursuant to Section 1-109 of the Code of Civil Procedure, the undersigned certifies that the statements set forth in this instrument are true and correct.

/s/ Julie L. Young
Julie L. Young